



Cera Sanitaryware Limited

Q2 FY 2023 Earnings Conference Call Transcript

November 9, 2022

Moderator: Ladies and gentlemen, good day, and welcome to the Q2 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 "*" then "0" on your touchtone phone. Please note that this conference is being recorded.

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

Mayank Vaswani: Thank you, Yashashree. Good morning, everyone, and thank you for joining us on the earnings conference call for Cera Sanitaryware Limited for the Q2 FY23 earnings, which were announced on Monday.

We have with us today the management team comprising Mr. Ayush Bagla, Executive Director; Mr. Rajesh B. Shah, CFO and COO; and Mr. Vikas Kothari, Deputy CFO of Cera Sanitaryware. We will begin the call with brief opening remarks from the management, following which we shall open the floor 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 the detailed note in this regard is contained in the earnings 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 second quarter and half year ended 30th September 2022, were adopted by the Board of Directors on 7th November 2022. The earnings documents have been released to the stock exchanges.

At present, our manufacturing facility continues to function at high utilization levels. Capacity utilization for Q2FY23 for Sanitaryware was at 115%, and we endeavor to operate the plant at similar levels all through FY23. In Faucetware, the capacity utilization was at 116% during Q2FY23 and all efforts are on to maintain these levels.

As indicated in our previous earnings concall, our current production for September 2022 at the Faucetware plant has been 2.9 lakh pieces. In FY21, it was 1.25 lakh

pieces per month. In FY22, it was 2.18 lakh pieces per month. The current production is a 132% increase over the production level of FY21 and a 33% increase over FY22.

The faucetware expansion program to take capacity to 4 lakh pieces per month commenced from July 2022. Requisite approval from the Gujarat Pollution Control Board were obtained. The enhanced production is scheduled to go on stream in July 2023. The total cost of project is INR 69 crore to be funded entirely from annual operating cash flow. The cost breakup is, 'Building and Civil work' INR 37 crore, 'Equipment and Plant' INR 24.75 crore, 'Electrical substations' INR 7.5 crore. The product mix planned is colored SKU's, quarter turn SKUs, PVD SKU's and a few more SKU's that can be taken in, from outsourced partners.

So far, not a single day of disruption of current manufacturing has taken place. The market has been continuously fed with products from the existing plant. We expect to end FY24 with an output of 4 lakh pieces per month. In April 2022, newer value-added SKUs in Faucetware were introduced at the National Dealer Meet. SKUs in 4 ranges and in 6 colors were introduced to the trade. These value-added products included Black Matte finished faucets, Red Matte finished faucets and other PVD products. An intensive range of Rose Gold, French Gold, Yellow Gold products were part of the event. These new products are being gradually rolled out with a grand display at 100 dealer's outlets. Over time, these new ranges will provide 319 SKUs.

The Sanitaryware plant is operating at a capacity utilization of 115%. This is the highest utilization in the past 10 years for Cera. If you look beyond the numbers, the capacity is very agile allowing shifting between outsourced SKUs and manufacturing SKUs, some of which may require shorter runs. Certain products, which used to be outsourced within India and from China are now taken in and are being manufactured in-house. The plant can, in a cost-effective way, manufacture short batches of SKUs whenever required.

China imports in FY21 were INR 57.2 crore or 4.76% of sales. In FY22, China imports were INR 67.87 crore or 4.71% of sales. In H1 FY23 China imports were INR 27.66 crore, only 3.41% of sales. Cera was already one of the lowest users of products Made in China and with availability of manufacturing infrastructure in-house, the percentage of Chinese imports to sales have been continuously declining. In a business, which is brand driven, the fulcrum of success is now completely manufacturing and plant efficiency.

For fresh capacity for manufacturing 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 in discussions for those land parcels. Since capex will commence post land acquisition, the detailed

plans of the phase-wise capital expenditure will be made available. So far, no binding or nonbinding documents have been signed for any land parcel.

As on 30th September 2022, our cash and cash equivalents stood at INR 573 crore against INR 485 crore in September 2021 registering an increase of INR 88 crore or an 18% increase. Positive cash flow for Q2 FY23 has been INR 50 crore as compared to INR 45 crore in Q2 FY22. Therefore, going forward, only internal accruals are being used to fund the two capex programs. And we would also retain the flexibility to use some part of the cash and cash equivalents, if required. I would like to reiterate that no debt raising, or equity dilution is planned or required for both the capacity expansions.

Q2 FY23 also continued to witness stable raw material behavior in Sanitaryware and a downward bias in raw materials for Faucetware. During Q2 FY23, no price hikes were undertaken.

On the Sanitaryware business, key items like China clay, feldspar, Plaster of Paris, which constitute more than 95% of Sanitaryware's raw material mix had no impact. Within the glazing recipe, which constitutes less than 1% of Sanitaryware's raw material mix, the key constituents has moved down by 16% during Q2.

Due to the 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 remained stable at INR 25.72 per cubic meter in September 2022, which was INR 25.69 per cubic meter in June 2022. In Q2FY23 GAIL provided 54% of the gas requirement of the Sanitaryware business. Sabarmati Gas, a JV of BPCL and GSPC's pricing went from INR 73.58 per cubic meter in June 22 to INR 75.38 per cubic meter September 22. Sabarmati supplies 46% of the gas needs of the plant. Gas costs constituent is 3.12% of Cera's topline. There have been no changes in the price of ancillary cost items like transportation cost. The cost of corrugated boxes have remained stable.

Our high reliance on renewable energy for over 2 decades has significantly benefited us given that 63% of our electricity needs are met from wind and solar power sources. As a result, we have been able to keep significant parts of our cost basket stable.

Onto some further developments in the retailer loyalty program, which was launched by Cera in Q1 FY23, which is now almost completed 6 months. More than 13,000 retailers have already used the retailer app. These retailers form the bulk of Cera's distribution reach. We expect the total number of retailers to be around 15,000 plus who most likely will be part of this loyalty program by end FY23.

The feedback received from retailers has helped us in the understanding the consumer's changing demands, geographical segmentation of SKUs and evolution of the rewards program to retailers. Besides standardizing invoices in H1, more than INR 145 crore of sales to retailers have become eligible to receive rewards through this program. Many below-the-line marketing activities such as displays at the point of sale are being driven by this program. The Company's ability to tweak trade practices, trade pricing and ability to steer the direction of the dealer and retailer equation have all undergone a sea change. We have also seen an improvement in multi-brand retailers who have undertaken various initiatives to sell Cera products.

This ties in very well with our new product development. As product life cycle reduces, new product offerings at higher price points with dramatically new aesthetics and functionality are core to our topline and margin expansion. In H1FY21, 81 new products were introduced. In H1FY22, 3 new products were introduced and in H1FY23, 59 new products have been introduced.

In that backdrop, we can go over the financials:

Revenue from operations in Q2FY23 was INR 414 crore versus INR 393 crore in Q2FY22. EBITDA excluding other income, was INR 66 crore in Q2FY23 versus INR 58 crore in Q2FY22. The gross margin has improved at 56% in Q2FY23 against 51% in Q2FY22. The EBITDA margin is higher by 120 basis points at 15.9% in Q2FY23 versus 14.7% in Q2FY22, a growth of 14%. Profit after tax was INR 51 crore in Q2FY23 versus INR 42 crore in Q2FY22, an increase of 20.5%. EPS for Q2FY23 was 38.99% versus 32.36% in Q2FY22.

For Q2 FY23, 54% of the topline was from Sanitaryware, 34% from Faucetware, Tiles represented 10% and Wellness 2%. On a Y-o-Y basis, Sanitaryware revenues registered an increase of 10%, Faucetware revenues increased by 7%, Tiles decreased by 20% and Wellness increased by 10%. The Sanitaryware and Faucetware verticals remain the bedrock of our business with contribution of 88% to Cera's overall revenues.

We continue to witness encouraging demand for newly launched products. Products launched during the last 2 years contributed close to 24% of the revenues.

Products launched during the last 3 years contributed to close to 36% of revenues. Inventory days in Q2FY23 were 81 days compared to 60 days in Q2FY22. Receivable days in Q2FY23 were 26 days versus 36 days last year. Payable days in Q2FY23 was 36 days against 35 days in Q2 of FY22. Therefore, net working capital days in Q2 FY23 was 71 days versus 61 days in Q2FY22.

After a fairly low capex last year as against the capex budget of INR 17.19 crore for FY22, the total capex spend was INR 11.12 crore. In the current year, the capex

budget other than the brownfield Faucetware expansion and the proposed greenfield Sanitaryware capacity expansion programs are INR 24.6 crore of which INR 7.7 crore is for Sanitaryware automation, INR 6.4 crore for Faucetware automation, INR 6.6 crore for land and building and INR 3.9 crore for logistics and IT.

Cera's growth plan remains intact as it plans to expand capacities and to monetize rising demand. After taking a few years to break the INR 1,250 crore to INR 1,350 crore topline band, in FY22, Cera touched the topline of INR 1,446 crore. We all saw the impact on EBITDA and PAT margins. Going forward, Cera is set on a new topline trajectory, which we can all witness in the Q1 and Q2 numbers. Every decision made at Cera is from the shareholders' point of view with ROCE, payback period and impact on EPS fully considered before being placed for deliberation amongst the Board of Directors.

The classification of sale in FY22 was 42% in the premium category, 28% in the mid-category, 30% in the entry category. In Q1 FY23, the data classification had an error and should be read as 43% premium category, 30% mid category, 27% entry category. There is now standardization of classification based on price point and positioning of SKUs and therefore, the data for classification of sales in Q2 FY23 is 43%, in the premium category, 30% in the mid-category and 27% in the entry category.

Cera has launched a new ad campaign with brand ambassador Kiara Advani and Vijay Devarkonda titled, "It's your space, Play it your way". We have received very positive feedback on the campaign as the brand moves up the pricing and design pyramid.

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

Moderator: We have our first question from the line of Disha Sheth from Anvil Research. Please go ahead.

Disha Seth: Sir, our topline has grown by 5% and our volume growth in Sanitaryware and Faucetware is upwards of 10% and 7%, respectively. Sir, is there any price hike we have taken, if you can throw some light?

Ayush Bagla: So, Disha, the Company is now at a very crucial stage of metamorphosis. Normally, the number of new products and the new products we always used to classify as the products launched in the last 3 years used to be around 22% to 24% of sales. This quarter it is 36% of sales. So new products with complete change in aesthetics and functionality and therefore, at a much higher price point is the way to go. And, you know, we are a market leader. So, we asked ourselves a question, who is looking

out for the consumer? The leader has to guard the price. And with softer raw materials, softer cost base, there was no compulsion to increase the price, even though we have pricing power, the brand promise and brand salience are so strong, we could have taken a price rise in Q2, just like we had taken at the beginning of Q1. But enough price rises were taken all through the last 15 months. So, we believe for the short term, there is no compulsion to take a price rise. And in case, our peer group takes a price rise, we will gain a tremendous market share. So, these are some of the efforts being made to not only remain as a leader but gain market share.

Disha Seth: Okay. So, we are not even planning to decrease it because of the market leadership?

Ayush Bagla: No, decrease has never really happened even in the past.

Disha Seth: Okay. So, sir, the sales are 5% but volume growth is 10% for Sanitaryware. So that's why the difference is because of the Wellness, Tiles degrowth, is my understanding, right?

Ayush Bagla: No, the value growth in Sanitaryware is 10% and Faucetware 7%. And overall, the company's topline, if you add all the income, it has grown 6.25%. So, Tile, as you know, we have virtually no capital employed in that business. We have no fixed assets in that business. There is just a little bit of capital deployed in working capital. It's a pure trading business, and we retain the flexibility to keep changing our product mix to get to an optimum EBITDA number. So, the gain for us in Tiles is not to gain, reach a certain number in topline, but to reach a certain EBITDA percentage number.

Disha Seth: Okay. Sir, also as a shareholder, we would like to see volume growth, but just stressing on that what you mentioned 10% and 7% is a mix of volume and price or only value growth, then what would be the volume growth?

Ayush Bagla: It is purely value growth. And I'll tell you the reason why I emphasized on that. See, right now, we are dealing with in Sanitaryware 518 SKUs, with almost 100 SKUs being added every year. So, it is not difficult for a Company like Cera to increase volumes by continuing to sell mid-level products. But as the Company moves up the value chain, the pricing chain and design chain, volumes will not be the driver of growth. Value is the best way to look at the Company. Again, in Faucetware, you're dealing with 994 SKUs.

Disha Seth: Okay. Sir, our volume growth this quarter would be how much then?

Ayush Bagla: Again, the volume growth is not the way to look at the Company.

Disha Seth: Okay, sir. And sir, going forward, margin, if you can throw some light since you mentioned they are on the downward trend. And we do not plan to increase price

and keep it stable. So, we can see our gross margin expansion and also EBITDA margin expenses. My understanding is right?

Ayush Bagla: Yes, what you said was raw materials are on a downward trend, especially brass. So, zinc, brass and faucetware, they have declined, and I can give you some details on that. In Sanitaryware, 95% of the RM is these 3 items: feldspar, China clay. So here, there has been no increase in Q2. In zinc, there has been a slight increase last year, but that's less than 1% of the RM basket. In the glaze recipe, there's a 10% increase last year and no increase in Q2. So overall, there was almost a reduction in the Sanitaryware basket. In Faucetware, the reduction was even more pronounced because zinc and brass both declined, sorry zamak and brass both declined. Brass declined from INR 545 to INR 495 per ton. There was a saving of INR 3.82 crore in the quarter. And zamak declined INR 371 to INR 317 per ton and the savings only in this quarter was INR 30 lakh.

Disha Seth: Okay. So, we can expect a gross margin expansion, or it will restate even going forward?

Ayush Bagla: Again, gross margin has already expanded. The 56% is our all-time high. And the way that has been achieved is not only through RM decrease but sweating the assets more and making sure that the efficiencies have increased.

Disha Seth: Okay. And sir, operating leverage must be also at the peak since we're sweating it so nicely. So, more leverage may not be possible because we're already running at plus 100 capacity?

Ayush Bagla: No, more leverage is possible because the SKUs at the bottom end will be continuously moved out to our vendors and higher-end SKUs be taken. And some SKUs, which we used to import from China have also been taken in. The reason for import from China was not that we couldn't make it in-house, the reason was the quantities of those SKUs were very small. We didn't want to have short runs in the factory. But now the factory manufacturing capability is agile enough to allow for these short-run SKUs.

Disha Seth: Okay. And sir, your medium-term guidance for the sales growth if you can specify this?

Ayush Bagla: So, once we achieve INR 1,440 crore in March '22, we had said that we will double in 40 months, and that remains intact. And the best way to look at this is if you look at the H1 numbers now, normally, H1 is 45% of sales. So, you'll have a pretty good estimate of FY23 and then beyond. The numbers we are looking at is a dramatic, H1 is 30.52% over last year's H1.

Disha Seth: Yes. Because of the lower base in Q1 FY22 maybe because of COVID?

- Ayush Bagla:** Correct.
- Moderator:** We have our next question from the line of Pritesh Chheda from Lucky Investment Managers. Please go ahead.
- Pritesh Chheda:** Sir, I wanted to know the asset turn on the capex of Faucetware of INR 70 crore? And what would be the capex in the greenfield Sanitaryware whenever you plan finally and what will be the assets turn there?
- Ayush Bagla:** Asset turn Faucet will be higher simply because we're getting a lot of advantages of the current facility. There's no cost of land, etc. Cost of civil is also maybe half of what it would have been in a greenfield facility. So, on INR 69 crore, asset turn will be between 2 and 3 once it's commissioned. But a lot will depend on which SKUs are made. So, this number can be reinvested once the plant has been operating for 6, 8 months, but current numbers based on what we plan on producing will be about between 2 and 3.
- In Sanitaryware, we had identified the two land parcels, but we didn't reach a conclusive end of a binding or nonbinding document. So, we are looking at a few more locations. Land prices in Gujarat have gone up, availability of labor, water and gas, all 4 factors confluencing has not been so easy. So that is why I mentioned that no document has been signed for any land so far. So, we hope to complete something before March '23.
- Pritesh Chheda:** But what approximate capex in Sanitaryware would happen?
- Ayush Bagla:** Land would cost INR 25 crore, and the overall plant we estimate right now will cost INR 129 crore.
- Pritesh Chheda:** An asset turn on this INR 150 crore?
- Ayush Bagla:** No, together, it's INR 129 crore. So, asset turns will be above 2. But again, it will be a function of which SKUs are made in a current manufacturing facility and which SKUs in the newer one.
- Pritesh Chheda:** So, until this capacity comes, you have the scope of improving your product mix within your existing capacity, right, sourcing versus buying from outside?
- Ayush Bagla:** Yes, that's right. And that is the reason you are seeing improvement in gross margins.
- Pritesh Chheda:** Okay. So, if I have to look at your strategy incrementally on having slightly more premium products and also better utilizing our own asset by what to purchase and

what to make in-house, the 16% margin that we see have actually a scope for an upside buyers and can improve as you double your revenue over the next 40 months?

Ayush Bagla: Yes, we would be, I would say we would be satisfied with the 50 to 75 bps annual increase in EBITDA margins in this journey. And that has already happened between '21 and '22, more than that has happened. Even currently, you're seeing more than that happens. So, we will just say on an annualized basis, anything above 50 would be a very welcome development.

Pritesh Chheda: Okay. And sir, lastly, if you could give for H1 '23, what was the Sanitaryware, Faucetware, Tiles and Wellness revenues? And for Q2 also?

Ayush Bagla: Yes, I can give you H1 numbers, INR 436.82 crore in Sanitaryware versus INR 315 crore last year in H1. Faucetware was INR 278 crore this year versus INR 201 crore last year. Wellness INR 14.46 crore versus INR 11.5 crore last year, Tiles INR 79.21 crore versus INR 85.66 crore last year, that was H1. I'll give you Q2. Q2 Sanitaryware was INR 225.19 crore this year versus INR 203.97 crore last year. Faucet was INR 141.76 crore this year versus INR 133.01 crore last year, Wellness INR 7.81 crore this year versus INR 7.11 crore last year, Tiles INR 38.72 crore versus INR 48.46 crore last year.

Pritesh Chheda: And any reason for a slightly slower growth, what we see this quarter?

Ayush Bagla: Again, this is the outcome of a metamorphosis that the Company is going through. You have seen our latest add campaigns. That completely repositions Cera and the consumer's mind. We are now trying to compete both with MNCs with companies which import not only from China, but from Western European countries and also from our traditional peer group who are large sanitaryware players. So, we will have already product approach the entire pricing pyramid. And the emphasis of the Company is to make sure the share of premium items continues to increase.

Pritesh Chheda: You mentioned that H1 is 45% of the revenue, right?

Ayush Bagla: Yes.

Pritesh Chheda: Okay. I was not convinced by the answer which you gave for slower growth of 7%. So, was there a distribution change or anything because of which, was there product SKU realignment where you are slowly migrating to a premium SKU? That's the reason, I couldn't actually comprehend the answer that you mentioned for slower growth.

Ayush Bagla: See, we were always like higher growth and we would like industry-beating growth, but that has to be looked at in all from 360 degrees. You can't have growth with

increasing receivable days. You can't have growth with suddenly expanding in a geography after spending INR 10 crore on launch. So being a listed Company and a highly disciplined financial Company, we take all those factors into account before making any moves in the market. The name of the game is retain your core base, your core identity of SKUs and keep on launching new SKUs, so that share of new SKUs may not necessarily take place in volume, but tremendously in value. So, I would only request you to look at one statistic that I read out, share of new products were always between 22% and 24%, share of products launched in the last 3 years, but now they are at 36%. That is a tectonic shift in the Company's functioning.

Moderator: We have our next question from the line of Shrenik Bachhawat from LIC AMC. Please go ahead.

Shrenik Bachhawat: Sir, my first question is, as we have seen recently, pipe players like Astral and Prince have entered the Bathware segment. And these guys have strong distribution in Tier-2 and below markets, which is the core market for us, which is 80% of our revenue, right? And also, there is the overlap benefit they have, where the hardware stores who sell the pipes also sell the bathware products. So, we were reducing our focus on metros because of the competition of MNC, but do you see an increasing competitive intensity in the Tier-2 and below cities because of these pipe players coming in our business?

Ayush Bagla: You're in the market, you know the numbers. The pipe companies have not really been able to achieve scale so far, maybe they make all the correct moves going forward. The kind of pressure that the financial community has put on them, they are more to become B2B suppliers. And transferability of a brand from behind the wall to front of the wall is very, very difficult. We are seeing that even tile companies with such strong financial muscle, distribution muscle have not been able to transfer their brand from Tiles to Sanitaryware and Faucetware over the last 15 years. So, transferability from a low-end product, which is completely commoditized to a high-end design and aesthetic-based product is not easy. And I mean I'm waiting to see more evidence on that. So far, there's no evidence that has been put in front of us, whether the consumer has accepted them or not accepted them.

As far as Tier-3 is concerned, you see the census says all population centers above 1 lakh is in Tier-1 town. But our definition for easy understanding, we have said Tier-1 towns of population centers above INR 25 lakhs. And Tier-2 cities are between INR 10 lakh and INR 25 lakh and Tier-3 cities, we classify for discussion purposes only as population centers below INR 10 lakhs, which is a very broad range. Which is why you see that number. So currently, the number this quarter was 27, 12 and 60. And that 60 number if we were to further reduce the band from INR 10 lakh to INR 5 lakh or even INR 2.5 lakh, that number will get more evenly distributed between Tier-1 and Tier-2 cities.

Shrenik Bachhawat: Could you also throw some light on the demand scenario in metros versus Tier-2 cities, like is there any sharp gap or broadly similar?

Ayush Bagla: I would say demand continues to be strong and most important is the B2C demand where interest rates are not a deciding factor, unlike in the B2B demand and the new apartments offtake category where interest rates are, of course, one of the factors that determine velocity of sales. So, Cera's focus is completely on the B2C category, where the consumer is neither taking a loan nor is trying to time his home improvement with any kind of economic cycle. So that's our focus that remains strong in all categories.

Shrenik Bachhawat: And basically, we're talking about sharp growth in our numbers, but where do we see our Tiles segment? How should we as analysts look at the Tiles segment? Is it just a side segment where we will not concentrate or how will we see that growth?

Ayush Bagla: The Tiles segment, in any case, for the last so many years, we derisked our balance sheet from the Tiles segment. We participated in equities in 2 JVs. One we have exited, the other one is not currently working. But our total exposure to the JV is only INR 8 crore. So other than that, there are no assets on the books. It's a purely trading venture. Currently, the Tiles industry is going through a lot of upheaval and that you are seeing in the results of many tile companies. The upheaval is because there is tremendous overcapacity of tile players in Morbi and other places.

There is no pricing power even with the brands, and there is no product differentiation between different players. So, till that upheaval subsides, it's a very difficult call to try and increase your share of tiles. And in any case, it's the lowest contributor to profits in Cera. So, you are seeing that when Tile was 17%, 18% of the P&L, the margins were much lower than what it is now when Tiles are 9% to 10% of the P&L. So, the focus right now is to be a niche Tiles player, try and sell double charged, triple fired GVT, some walls, some paving tiles, a mixture of tiles, which are not fully commoditized.

Moderator: We have our next question from the line of Rahul Agarwal from InCred Capital. Please go ahead.

Rahul Agarwal: I have 3 questions. Firstly, on capex, I understand the regular part of it, which is a INR 25 crore breakdown you gave. On the Faucets side, INR 70 crore largely should be spent in this year, but I'm seeing the first half at INR 10 crore. Could you help me with timelines for Faucet expenses purely on cash capex, and then I'll come down to Sanitaryware capex.

Ayush Bagla: Faucet is a total of INR 69 crore, and we started in June, July this year after requisite approvals were in place. So, so far, a very small portion of that INR 69 crore, a bulk of it has been spent in advances to plant and equipment manufacturers, technology

suppliers and a little bit in civil works. So, bulk of it will be more end loaded and you'll see bulk of it in Q3, Q4 and also Q1 and Q2 of FY24, a total of INR 69 crore.

Rahul Agarwal: So, by census by June of 2023 Faucet starts, so bulk of it should be done by April, May of 2023. Is that correct?

Ayush Bagla: That's right.

Rahul Agarwal: So, second half, obviously, will be capex heavy on Faucet?

Ayush Bagla: That's right. Out of the INR 69 crore.

Rahul Agarwal: Right. And on Sanitaryware, obviously, it's not finalized yet, but you will spend INR 25 crore on land which should happen by March and then bulk of the balance of (inaudible) should come down in fiscal '24. Is that correct?

Ayush Bagla: '24 and '25. It will be 18 to 24 months of capex post land acquisition.

Rahul Agarwal: Okay. 2-years post land acquisition.

Ayush Bagla: That's right.

Rahul Agarwal: Okay. Got it. Second question was on growth. So, Sanitaryware plant obviously will come much later. Right now, you've fully utilized, the plant is full for second half. So, the growth next year is taken care of from outsourcing. Is that understanding correct?

Ayush Bagla: No, you see, if we look at our commentary from before COVID in Jan '19, even in March '19, we had said that the industry faces a problem of availability. And at that time, that message didn't find too much resonance because nobody, no other listed players talks about availability problems. But we said the pace at which demand is growing, capacity across the board for the industry has not kept pace. And that is something we witnessed in the first half of the COVID period as well, not because of factory disruption, but demand completely excluded. Now this is the first time this year that we have had no shortage of a single SKU in a single geography. And it has been our aim to keep on increasing inventory days just because there is no cost of carry. There is no cost of obsolescence. So, it was an important objective to have achieved. And going forward, we will keep this 80 to 90 days inventory days. We will keep on outsourcing lower-end products to third-party vendors. Incidentally, I just wanted to share with you that the cost of Indian vendors is 35% to 45% lower than Chinese imports even after container costs have come down from INR 6,000 per container to INR 1,500 per container in September. So Indian vendors and Indian outsourcing is a way to go and to keep freeing up infrastructure and capacity in the own plant to make newer SKUs.

Rahul Agarwal: Sir, the question is, next year, for Sanitaryware, if you, let's say you grow between 10% to 15%, where does this growth come from? Because you're anyway at 115%, you will still be the same in second half. So, do we go to like another 15% on that overcapacity utilization, that's how we should look at it?

Ayush Bagla: We'll be making newer SKUs, which were launched last year and this year in our own plant, and our vendors will be making the traditional SKUs. But in rupee terms, you will not see an outsourcing increase. Because the value increase in in-house production will be much more disproportionately higher.

Rahul Agarwal: Okay. Now I get it. I get it. And lastly, on the other income, the first quarter was negative. That question remained unanswered last time. Second quarter is INR 10 crore. What is really happening there? Why is the fluctuation?

Ayush Bagla: Because we take as per IndAs, we did M2M valuations of all our mutual funds, which are all in safe instruments. So even GOI bond funds had fluctuations when the interest rate cycle in April and May spiked, but they settled down. So, this was all noncash charge. Even out of the INR 10.95 crore you see, INR 8.34 crore is M2M changes. Only INR 2.61 crore is actual cash flow.

Rahul Agarwal: Okay. I get it. And lastly, just to clarify on the capex. So, about INR 25 crore in Sanitaryware land, above INR 25 crore in regular capex, that's INR 50 crore and another, let's say, INR 30 crore, INR 40 crore on Faucets, that's close to INR 90 crore this year. Then there will have another INR 20 crore regular next year and about INR 100 crore, about, let's say, INR 70 crore, INR 80 crore of Sanitaryware. So that's another INR 100 crore. So, about INR 100 crore average this year, next year capex is fine from a cash perspective?

Ayush Bagla: Yes. And that will be just half of our annual operating cash flow. So, they most likely will not be a need to depend to the treasury reserves.

Moderator: We have our next question from the line of Akhil Parekh from Centrum Broking. Please go ahead.

Akhil Parekh: Ayush, my first question is on the mix in terms of in-house manufacturing versus outsourcing for this quarter and how it was in 2Q of FY22, for the 2 categories, basically Sanitaryware and Faucetware?

Ayush Bagla: The mix in terms of premium and...

Akhil Parekh: No, the in-house manufacturing versus outsourcing you mentioned?

Ayush Bagla: Okay. In-house in Q2 was 40% in Sanitaryware, outsourcing was 60%. In Faucetware, in-house was 48% and outsourcing was 54%. Versus last year, in-house in

Sanitaryware was 41%, outsourcing was 59%. In Faucetware, in-house was 43% and outsourcing was 57%.

Akhil Parekh: Okay. And what you just commented like previously, that this contribution from in-house will kind of go up mainly because of better product next year, FY23?

Ayush Bagla: That's right.

Akhil Parekh: Okay. And second question is a general demand trend, right. There is mix reviews that we keep hearing in terms of the real estate market, given the interest rates are going up. If you can just qualitatively highlight how it is in a Tier-2 and Tier-3 market vis-a-vis premium markets or urban market basis?

Ayush Bagla: We find no change in any demand trends. And maybe what you have heard is more tiles driven because the tiles industry is going through once in a lifetime or once in 30, 40 years upheaval with too much overcapacity. And no product differentiation between the lowest end players and the brands who charge a higher price. So that really reduces the pricing power. Those are the reasons for the upheaval in Tiles rather than any demand-led upheaval. In Sanitaryware and Faucetware, we have not found any trends so far, which are different in Q1, Q2 or even in October.

Akhil Parekh: Okay. Sure. And second question is on this Faucetware capacity, which we're going to commence. Like I mean this 4 lakh pieces per month. So that complete absorption will happen by end of FY24 or probably by first half of FY25?

Ayush Bagla: So, after July '23 when the plant starts producing those numbers, it might take a few months to reach that final INR 4 lakh per month destination but that will definitely happen during that financial year.

Akhil Parekh: Okay. So '24 itself basically, end of '24 itself, we should see complete absorption?

Ayush Bagla: Yes.

Akhil Parekh: Okay. And last question on the Tiles segment, we are kind of defocusing from this segment. And I believe this year, '23 will kind of be flattish vis-a-vis FY22. So, going ahead, should we anticipate this category to remain at that level or probably even decline, say, for FY24 and '25?

Ayush Bagla: First of all, the first filter we use is we don't want to deploy more capital in Tiles. That's the first filter. Second filter is we need a certain EBITDA percentage in every sale that we do. So that is only possible in high-end double charged and triple fired GVT. And that's where the concentration is. So, we are not that focused on a certain top line to be achieved in Tiles. And Tiles have gone through a major upheaval and Cera has been completely spared of that upheaval. If we were a larger player, then

we would have somewhere gotten flinched like all other players have gotten flinched.

Akhil Parekh: Sure. This is helpful. Sorry. And one last piece, I missed the gas prices at Sabarmati and GAIL for this quarter, how it was and how it was last year?

Ayush Bagla: The cash number?

Akhil Parekh: No, no. The gas prices.

Ayush Bagla: Okay. I'll just give you the gas prices. Average from GAIL which is about 56% of our consumption was INR 25.70. And from Sabarmati, which is 44%, 45%, was INR 74.87. Weighted average after considering the respective shares is INR 48.56, which is dramatically lower than anybody's average.

Akhil Parekh: And how it was last year in GAIL and Sabarmati?

Ayush Bagla: GAIL last year I'll give you the number for the full year '21, '22, GAIL was INR 11.13; Sabarmati was INR 59.46 and the weighted average was INR 32.93.

Akhil Parekh: Okay. So, from INR 32.9, it has gone up to INR 48.5?

Ayush Bagla: Yes. So, this INR 16 in Cera's case works out to about INR 15 crore. The annual impact is INR 15 crore.

Moderator: We have our next question from the line of Akash Shah from UTI Mutual Fund. Please go ahead.

Akash Shah: And I just had two questions. One, from Q2 FY22 to Q2 FY23, what would be the price growth that we would have taken in Sanitaryware and Faucetware segment?

Ayush Bagla: I'll give you the breakup also of the price. After Q2 last year, in November was the first price hike of 10% in Sanitaryware, 5.5% in Faucetware and then there was no price hike till May 2022, 3% in Sanitaryware and 5% in Faucetware. And both came with the lag effect because dealers rush to place orders when there's an announcement of price hike and some orders need to be fulfilled at the old price as well. So, with a slight lag, there have been 2 price hikes between the two Q2s.

Akash Shah: Yes. Understood. Ayush, so going forward, how should we think percentage contribution of Tiles would be to our overall topline? Would it be 10%, 15% of revenue? Or I mean, or would it go to 20%, maybe 1 or 2 years down the line?

Ayush Bagla: I would say any number between 8% and 12% would be a very comfortable number because that would make sure that our estimate of margin increase at the EBITDA

level of 50 to 75 basis is maintained. And if the Company adds between INR 350 crore to INR 400 crore of topline annually, so Tiles could be anything between INR 150 crore, INR 180 crore business.

Akash Shah: Yes. Understood. And so, we have around, please correct me if I'm wrong. We have around INR 485 crore of cash as of September 2022. So, any thoughts on how we are planning to utilize this cash because internal accruals would be able to fund the capex plan that we have. So, any thoughts around that?

Ayush Bagla: INR 485 crore was the number in September '21. In September '22, it's INR 573 crore. And in any case, last year, there was a special dividend on the 40th year of the Company in addition to the regular dividend. So, dividend is normally 17%, 18% of PAT last year, of course, the number instead of INR 20 crore was INR 46 crore. So, let's see, based on the capex needs, the growth of the Company, the working capital needs, the Board will decide on this year's dividend. Normally, that ratio of the last 6 years has been 17%, 18%. But other than that, growth is something that the Company is more interested in rather than using the cash for any other purposes.

Akash Shah: Yes, understood. And just one last question, if I can. So, if I look at H1 FY23, we have clocked around 54.8% gross margins, which was higher than even H1FY19. So broadly, can we build this gross margin as a sustainable number going forward? Or this may once again may revert to 50% to 53% that we have seen in past?

Ayush Bagla: There are a lot of activities being carried on in the Company. The trade margins are being negotiated wherever they can. The cost basket is being analyzed on a regular basis. The aim is to keep on increasing the gross margins, unless something volatile happens in the RM basket, labor basket or transport basket. We don't see the gross margin changing. Only one addition that I'd like to highlight to you is that the Company has embarked on a new advertising and publicity campaign that will play out over the next 6 to 8 months and that will be an extensive campaign, but that will upgrade the brand tremendously, the benefits of which the company will get at least over the next 5, 6 years in higher sales. And the company is trying to increase its sales by 1.25 times annually. So, this kind of brand upgradation and repositioning upwards, this was an exercise that was required, and you're seeing the benefits of that. So that is the only major change, but that will not influence COGS or gross margins that will come right at the selling and marketing expenses and other expenses side.

Akash Shah: Yes. Sir, and just one last bookkeeping. Ad spends for the year for FY23 would be how much percentage roughly?

Ayush Bagla: Normally, they are 3.5%, 4%. This year, we could look at 5%, but that is subject to further discussion during Q3 and Q4.

Moderator: We have our next question from the line of Udit Gajiwala from Yes Securities. Please go ahead.

Udit Gajiwala: Just broadly you have answered all the questions. Just one thing that for H2, we are aiming, just revising the number that you said that H1 is 45%. So, if I just do a simple math, we are aiming for an 18% year-on-year growth in H2. So how much, I know you don't would like to comment on the volume thing. But given that we are not looking at any price hikes, what gives us the confidence of achieving such growth?

Ayush Bagla: See, price hike is not on the table at the current moment. So, I mean, we're talking about early November. In the short term, there is no discussion on the price hike. In the medium term, which is end of Q3 or Q4 is too long a time period to talk about price hikes given the changes in RM mix that we see. But the growth will come from new product introduction. And which is why we are not that focused or not that hung up on pure volume growth because we want to keep on increasing our share of premium products, where the margin profile, the brand image all come into play.

And there are 3-4 other things that have been done in the background. Cera is the only Company which has not outsourced its aftersales service to third-party contractors. We are the only Company which has pierced a 10-year ceiling in Faucetware warranties. Our Faucets comes with a 15-year warranty on the forged brass piece in the Faucet. So those are the things which have been done behind the scenes to make sure that our share of new products continue to grow and our market share grows.

Udit Gajiwala: Understood. So, sir, would that imply that the dealer inventory would be at a normalized level or they are stocking up or what would be the on-ground scenario, currently?

Ayush Bagla: First of all, the Company has to have inventory, and we have less than 19 distributed warehouses, which have to carry so many SKUs. So, if the Company has inventory, then there will be availability to the dealers, which is a very important metric for the way we look at sales. We have achieved that over the last 12 months. After many years, we want to keep that intact. The 80 days of inventory that you see does not include the dealer inventory. And dealers, they have access to just-in-time inventory, in most cases, 2-3 hours away from them because it's the Company depots and warehouses which stock a very large scale of inventory. For them to have a high need for inventory is not there, because once the Company raises an invoice, the dealer has to pay. So, for them, there is no need to have a high inventory.

Moderator: We have our next question from the line of Akshay Chheda from Canara Robeco Mutual Fund. Please go ahead.

Akshay Chheda: My question was on the down-trading aspects. So how do you see that down trading happening in Sanitaryware and Faucetware going forward? Because at least in other categories, there are a lot of companies which are, atleast in other, say, building material categories, even the paint Company or even a plywood Company, so they are talking about a lot of down trading happening. So wouldn't that happen in our case because at least large part of our focus is on the premium side. So, I mean, how do you see that?

Ayush Bagla: In fact, we have seen trends which are contrary because the bulk of our new products like I explained in Faucetware, PVD, Black Matte, French Gold, Yellow Gold or water turns, all our premium category launches and over time, they'll be 319 SKUs. And share of new products has been increasing. New products are primarily in the mid and premium segment. So new product development, brand repositioning, new ad campaign all have tied in very well together. So, we are seeing exactly the opposite of the commentary many other companies have been providing. And there's one more reason for that, a lot of these companies are more focused on new home sales, which Cera is not.

Moderator: Thank you. I would now like to hand the conference over to management for 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's Sanitaryware Limited. Cera remains positive and its strong positioning in the industry and 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. Thank you very much.

Moderator: Thank you. 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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