



## S.H. Kelkar & Co Ltd

### Q3 & 9M FY19 Earnings Conference Call

February 07, 2019

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**Moderator:** Ladies and gentlemen, good day and welcome to the SH Kelkar and Company Limited's 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 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. Anoop Poojari from CDR India. Thank you and over to you, sir.

**Anoop Poojari:** Thank you. Good afternoon, everyone and thank you for joining us on SH Kelkar and Company Limited's Q3 and 9M FY19 Earnings Conference Call. We have with us Mr. Kedar Vaze – Whole-time Director and CEO; Mr. B. Ramkrishnan – (Head) Strategy and Mr. Shrikant Mate – EVP and Group CFO of the Company.

We will begin the call with opening remarks from the management, following which we will have the forum open for a question and answer session. Before we start, I would like to point out that some statements made in today's call may be forward looking in nature and a disclaimer to this effect has been included in the earnings presentation shared with you earlier.

I would now like to invite Mr. Vaze to make his opening remarks.

**Kedar Vaze:** Good afternoon everyone and thank you for joining us to discuss the operating and financial results for the quarter and nine-months ended December 31<sup>st</sup>, 2018. I will begin by taking you through the key highlights of the period and we will look forward to taking your questions and suggestions at the end.

Over the last three years, the Company has undergone high intensity market disruptions events such as de-monetization, GST and the recent raw material shortage. Despite the impact of these events, our business model and financial parameters have held up enabling the core business to keep delivering the gross margin in the range of 43% to 45% and EBITDA in the range of 17% to 20% albeit at a very subdued growth path.

In the quarter gone by, we witnessed an uptick in the demand in the months of October and November. The sales performance, however, in month of December came very below our expectations. Weak performance during the quarter was largely on account of domestic demand. Some categories witnessed a slowdown due to delays in GST refunds for customers, but as things get more streamlined we anticipate business in these segments to recover.



I am pleased that amidst this low sales period, we have retained all our customers and have in fact witnessed a healthy pace of new wins. We believe, financial performance is transient in nature and expect growth to normalize in the short-term. We have also been shortlisted to work as core list of preferred vendor with a few large accounts in Fragrances.

Our Fragrance division delivered a 6% growth in 9MFY19. Domestic Fragrance reported a 6% growth, while overseas revenues grew by 7%. In Q3FY19, domestic Fragrance reported a large degrowth, especially in the month of December. The overseas division continued its growth with the 13% year-on-year. The ongoing volatility in raw material prices, however, saw subdued operating profit during the nine months which stood at Rs. 103 crore as against Rs. 107 crore in 9MFY18. Margin stood stable at 15% in 9MFY19 and Q3 operating profit stood at Rs. 37 crore with margins at 16%.

On the operational front, we have focused our attention on ramping up our production in Greenfield facility at Mahad and are pleased to announce that the state-of-the-art facility commissioned in September is now fully operational and is manufacturing Tonalid and other key materials used for the Fragrance industry. This facility has now been audited by key customers. A new product business of Rs 15 Cr in addition to the existing contracts has been contracted for next year with large international customers. In this quarter, the full cost was approximately Rs.6 crore -- the depreciation and interest have been charged to the profit and loss for this quarter but the production has only been at around 15% of the full capacity. The full capacity is expected to be ramped up by March of the coming year.

Let me now briefly take you through the other segments:

On a consolidated basis, our revenue from operations in 9MFY19 stood at 773 crore, higher by 5%. On a constant currency, revenues were higher by 2.3%. Domestic revenues during 9MFY19 grew at 3%. While we were anticipating a much stronger growth in domestic revenues the performance in the third quarter dampened the overall business performance for 9MFY19. On the international front, our overseas revenues marked a growth of 9% during 9MFY19. In Q3, our revenue from operations came in at Rs. 255 crore, down by 10%.

On the profitability front, EBITDA during 9MFY19 stood at Rs. 124 crore with a margin of 16%. The employee cost during 9MFY19 increased by 4% year-on-year, owing to onetime expense of Rs. 5.4 crore, which we incurred to rationalize cost going forward. Pricing pressure on key raw material continued to impact profitability. As indicated earlier, the Company has undertaken price increases during this period to partially cover the unprecedented raw material inflation. This combined with several cost optimization measures taken by us over the last several quarters resulted in stabilization of gross margin. Gross margins in 9MFY19 stood at 44% as against 47% in 9MFY18. Gross margin during Q3FY19 improved sequentially and stood at 45%. Going ahead, we expect gross margin to stabilize and further improve once Mahad facility is fully operational.

In our Flavors division, the revenue stood at Rs. 80 crore in 9M FY19, up by 12% when compared on like-for-like basis adjusting for loss of Citrus business owing to raw material disruption. The domestic business has been flat year-on-year and overseas has marked the 21% year-on-year growth. During the third quarter, increased momentum helped register healthy 34% year-on-year growth in the overseas business. Domestic segment during the quarter registered for drop-of Rs. 2 crore owing to deferral of demand especially for summer products in segments such as Ice cream and Beverages. The 9MFY19 segment recorded operating profit of Rs. 10 crore with margins at 13% and in Q3 FY19, operating profit stood at Rs. 4

crore. Amidst this environment, I would like to highlight that our customer base has remained intact. We have continued investing in new technology and I am happy that the microencapsulation technology that we acquired last year is now in the final stages of commercialization, including orders from international customers.

To sum up:

We are executing many business initiatives with new product offerings, improving our operational capabilities with rationalization of costs across businesses. This will enable us to bounce back strongly in the coming quarters. Going forward, we look forward to delivering a healthy and sustainable performance in the immediate future. With this, I would now request the moderator to open the forum for any questions or suggestions that you may have.

- Moderator** Thank you. Ladies and gentlemen we will now begin with the question and answer session. The first question is from the line of Chintan Modi from Motilal Oswal Securities. Please go ahead.
- Chintan Modi** Just one thing to be understood, so the degrowth in revenue has come like a surprise, so wanted to understand - are we facing any issue in terms of visibility in the business because if I look at your commentary of second quarter it was more like we are in a recovery mode or the shocks are basically behind us and suddenly in the December month as you have noted down in your presentation that we saw this negative thing happening? Secondly, is it that we have lost a customer, so if you can help us understand it would be great?
- Kedar Vaze** As I mentioned earlier, there are certain segments, which have been covered by GST, where they are awaiting GST refund and a lot of their working capital cycle, they have deferred orders. So, we have seen this very steep change so we haven't really witnessed very large attrition in terms of customer loss, product loss, loss to competition. It is very difficult to ascertain exactly whether this is long-term or short-term deferral. We believe it should be largely a cash flow issue for the customers and then this business should restore. So, as of now we haven't heard any customer canceling orders, they've just deferred the schedule.
- Chintan Modi** But from a business visibility perspective, why is it that suddenly in December this thing has happened and if you can also tell us how was October and November for you in terms of growth and how much was the de-growth in December? I mean why such sudden change because of the GST?
- Kedar Vaze** Growth in October-November was very similar to Q2 FY19. I believe that customer would have put of stock in anticipation of demand in the Diwali season and the Diwali season may not have been as high demand as they were anticipating. So, the momentum thereafter in December has been largely affected by destocking, particularly in pockets of Home care, Agarbatti areas, where there was specific impact in addition to the working capital.
- Chintan Modi** But still then I believe the growth would have averaged out despite what has been happening? Can you justify this overall de-growth for the whole quarter?
- Kedar Vaze** Look at domestic Fragrance, it's where the big decline has come in and in addition the growth impetus from the AID in the Mahad plant, which we expect roughly Rs. 15 crore additional revenue has not fully materialized in this quarter. So, we were expecting that by November end, we would have this full sales coming in. We have got the production but the sales have not gone out as expected. I am saying it's a combination. There is a decline in the domestic Fragrance revenue and there is

anticipated uptick in the Mahad sales that has not yet fully materialized. These are the two events in December.

**Chintan Modi**

How would you see January then?

**Kedar Vaze**

January is as per track so it is on budgeted numbers. We are in a position to execute in excess of Rs. 100 crore a month. We are seeing the general traction back in the business.

**Chintan Modi**

Just a suggestion from my end; it could have been good if we had come up with some review note on this because this is something like clearly that is going against our commentary in Q2.

**Kedar Vaze**

I appreciate that suggestion and we will be more proactive in informing, if there are any changes in the business.

**Moderator**

Thank you. The next question is from the line of Ajay Bodke from Prabhudas Lilladher. Please go ahead.

**Ajay Bodke**

By when do you expect the raw material pressures to abate and by when do you expect the Mahad facility to reach optimum utilization level? You have mentioned in the presentation next few quarters, so could you be more specific about it and how do you expect the ramp-up to happen?

**Kedar Vaze**

On the raw material front, we are not witnessing any additional pressure. It has eased up in the fourth quarter. It continues to be a normal situation by and large, so there is no concern for deliveries or additional pressures on cost. On Mahad, we are today at almost 40% capacity ramp up as we speak and in moving the plant there was some additional equipment, which was coming from the Netherlands facility which has now been installed. By end of March, we will see a 100% available capacity in the Mahad plant. It has been 15% in Q3 FY19, it's already at 40% utilization and capacity production in January, expected to go to 100% by March.

**Ajay Bodke**

Could you kindly elaborate on the note #7 in the release regarding some charge you have taken Rs. 5.5 crore on business organization restructuring?

**Kedar Vaze**

In terms of last year versus this year, first half of growth and margin squeeze we have undertaken reduction in certain costs across the board. So, rationalizing the future growth rate and expectation to the cost structure, which we have built for the previous two years, we have been able to on an annualized run rate basis save roughly Rs. 13 to 14 crore of cost, for which we had to incur one-time cost of Rs. 5 crore this year.

**Ajay Bodke**

If you look at the return on net worth for the company, I think it's been trending down over the last few years. Does the company have any medium-term target about taking it up from the 13.8% in FY18 and what are the levels—in the medium term—that the company is looking for?

**Kedar Vaze**

I think if you look at this year specifically there has been almost Rs. 150 crore of investment in the Ingredients business - Mahad and Anhui which have just started giving the revenues. But the return on net worth or return on capital, if you kind of adjust the denominator by Rs. 100 crore, then that's in line with our long-term. But going forward, given the operating efficiencies that Mahad plant will bring we should end up, on an annualized basis, with Rs. 7 to 8 crore PAT improvement on the same set of sales revenue.

- Ajay Bodke** Do you have any medium-term targets in terms of the sales growth that you're looking at one should bake in for FY 20?
- Kedar Vaze** The Ingredients Mahad facility will enable the incremental additional Rs. 50 crore revenue for the coming year. That is the uptick in addition to the 12% underlying business growth, which we see on a regular basis.
- Moderator** Thank you. The next question is from the line of Kishan Shah from Isha Securities. Please go ahead.
- Kishan Shah** Just to clarify, you said that we are currently working at 40% utilization in our Mahad plant, am I right?
- Kedar Vaze** 40% production ramp up since it is a brand-new plant, they are taking production with the sequence of ramping up. So, they are not doing 100% on first month. They have started at 15%-20%, now they are at 40%, in sequential months, they will ramp-up production.
- Kishan Shah** We might achieve 100% by March?
- Kedar Vaze** That's right.
- Kishan Shah** The incremental revenues is Rs. 50 crore in FY20?
- Kedar Vaze** That's right. This will flow in February-March but ballpark figure Rs. 45 to 50 crore for next year in addition to regular revenues.
- Kishan Shah** Any guidance about FY21 in terms of revenue or growth?
- Kedar Vaze** We will defer this comment to make sure that we have the next 2-3 quarters, Mahad specifically up and running in the right frame before commenting 2 years down the line.
- Kishan Shah** With regards to an existing business at what rate are we working right now, what is our utilization level?
- Kedar Vaze** The Fragrance and Flavor plants are at around 50% utilization so there are ample capacities for us to ramp up revenues. The Netherlands facility, where we have largely reduced production because of Mahad, the capacity utilization at Anhui China plant today is at a full production level.
- Kishan Shah** In terms of the general industry in India and out of India, what is the condition right now? How is the demand shaping up and is there any additional supply that is coming on?
- Kedar Vaze** There is no major change in the competitive landscape in the business. There has been a lot of churn, unusually high level of new products and churn in the business due to price pressures. And I see in some segments, particularly, Detergent powder, some of the smaller people are losing market share to likes of large FMCG companies. There is a small structural trend, which will play out in the next two or three years. For the Domestic Fragrance business for us, the top 25-30 customers have witnessed 20% growth year-on-year even in this year. So, there is a good traction in the long term business. We are looking at some of the pockets of business which we have lost in December which is very unusual kind of a scenario. I would say it is a one-off kind of an event rather than ongoing basis.

- Kishan Shah** Could you just tell me what is the current debt on books?
- Kedar Vaze** The net debt in the group is Rs. 277 crore as on Dec 31, 2018
- Moderator** Thank you. The next question is from the line of Jigar Jani from Edelweiss Securities. Please go ahead.
- Jigar Jani** What was the month wise sales in the last quarter? How much did we lose in December?
- Kedar Vaze** I don't have the exact month wise number with me . But you can kind of look at a 35% reduction from end of November to December.
- Jigar Jani** On Mahad, you said that would be Rs. 50 crore incremental revenue in FY20. Also some of it we would be using in-house, so how much will it contribute in terms of saving to gross margins?
- Kedar Vaze** In terms of this year as well, we have increased our internal consumption by about Rs 30 crore, which is why we have been able to bounce back on the gross margins much faster than general market and the additional net increase in the revenue internal use we don't expect any significant jump next year because this year already we've jump by around Rs. 30 crore. I would say about roughly 1% margin improvement as a group due to internal production. Although it's not accounting number because we don't have the specific internal and external, only the external sales are reported. The internal consumption at sales value - external sales price, would be around Rs. 30 crore additional this year.
- Jigar Jani** What are the incremental sales if any expected next year from Anhui or we don't expect any significant upside from the Anhui acquisition?
- Kedar Vaze** The Anhui acquisition is actually at full capacity. We have invested small amounts to further debottlenecking. A major uptick will come from the Mahad and Vapi facilities where we expect around Rs. 50 crore of new business, which includes Rs. 15 crore of new business which has been contracted to large international customer.
- Jigar Jani** From the encapsulation technology you said that it is near commercialization, so would we see some kind of margin accretion from that or that would be at similar margins currently because it's a new technology?
- Kedar Vaze** The margins are similar to the rest of the business. It's another area of business, which opens opportunities in new applications, industrial applications and new markets. This is just where we have taken the first trials and the first commercial orders have been received and once that is fully commercialized, then we will be able to assess the actual potential of this business. To say that it is a new area for us and it's an exciting area for us.
- Jigar Jani** In the presentation that you have filed, you have mentioned that you expect normalization by Q1 FY20, so should we expect Q4 to be similar to this quarter or we can expect some sequential improvement in Q4?
- Kedar Vaze** I would expect Q4 to be better than Q3, both in Mahad facility and the regular business.
- Jigar Jani** You mentioned 12% growth for FY20, is just the volume growth or overall sales growth that you are referring to?



- Kedar Vaze** This would be volume growth. I don't see any price pressures at this point in addition to what has happened this year.
- Jigar Jani** So, we are not expecting any price hikes in FY20?
- Kedar Vaze** There will be some amount of differential pricing. But as a whole, on an average basis, we don't expect any large price increase.
- Jigar Jani** What would be your stable gross margins considering that we have basically seen raw material situations normalizing, what would be the guidance for next year ballpark maybe 45%-46%, what would be the guidance?
- Kedar Vaze** This quarter we are at 45%. I believe that it's a good level. Previously, we have reached higher gross margins than this. But on an average, I think in Q4 FY18, we had declined by almost 6% on force majeure events and we have been able to recoup most of that through a price increase and product rationalization. And hereon, we see across all the verticals the sort of churn of low value products in loss of revenue due to price increases already been factored and we would maintain the gross margin around 45% level.
- Jigar Jani** We made some acquisitions this quarter, which is mentioned in your note #6, although it's a small acquisition, what was that regarding?
- Kedar Vaze** Actually as part of vendor development, the promoters, 10-12 years ago had invested in the small manufacturing facility, which was largely doing some manufacturing of an intermediate product for the company. It has been formalized and most of its business is with the Keva as a supplier. So, we decided to move it into Keva Group as a joint venture.
- Jigar Jani** So, it's a promoter owned entity we are merging in?
- Kedar Vaze** It is a 50-50 JV with the third-party so the operating partner is a third-party. It was purely a financial investment by the promoter in a kind of a vendor development plan, which we used to assist some suppliers in terms of funding. So, it basically has been less than Rs. 1 crore of total payout.
- Jigar Jani** Yes it's a small amount I saw that.
- Moderator** Thank you. The next question is from the line of Kartik Mehta from IDFC Mutual Fund. Please go ahead.
- Kartik Mehta** On the gross margin, you have mentioned in your presentation that company expects a gross margin to stabilize once the Mahad facility becomes operational fully or ramps up the operation. So, when you use the word stabilize you mean to say that whatever you have done for 9MFY19, which is around 44% gross margin and there might be just 1% improvement to 45% gross margin next year? So, isn't it little lesser than what generally it should have been with the backward integration and all, your margin should improve further? Because last year in FY18, you had roughly 47% gross margin.
- Kedar Vaze** I think what we are saying is that there is an improvement in the gross margin, which we expect through the full ramping-up of Mahad facility. The other normal inflation between Fragrance and Flavors, ingredients continues to be high. So, as a total mix, we would see there a normalization at the level of this quarter of 45%. On purchase side, we would see some pressures on the sales side we would see some benefits.

- Kartik Mehta** Particularly in a Flavor division, the operating profit margin which used to be 20% last year has fallen to 12.9% - so if you can just tell what is the outlook over there?
- Kedar Vaze** We have a large chunk of business, which is rationalized and out of the portfolio during the cost increases on the Citrus oils. Net of that business we are now having those costs but we don't have that revenue to off-set and from hereon, the operating margins will continue to improve.
- Kartik Mehta** In terms of capex, if you can just tell me what was the nine-month capex and what is the full-year outlook for the capex for this year?
- Kedar Vaze** The capex for this year is largely done in the first half of the year, almost about Rs. 150 crore between the Mahad facility, some dividend, and the Anhui facility which we acquired in July.
- Kartik Mehta** Last year we did roughly Rs.121 crore capex and this year will be roughly Rs. 150 crore capex?
- Kedar Vaze** Yes. Last year it was largely linked to the acquisition in Italy. Just on that question, I think I would like to highlight that the acquisition in Italy is not reported as consolidated but the expected growth in terms of the business plan is materializing and there is more than a double-digit growth in that business this year.
- Kartik Mehta** If you can just give us the ballpark number of that business - revenue and profit numbers?
- Kedar Vaze** I don't have the visibility on the final profit number because we have to take into account amortization and the cost of the funding. But at the top line, the business grew in excess of 15% on a base of 30 million which was the base at which we acquired the business.
- Kartik Mehta** So, it will be consolidated at the year end and it's not reflecting in the current numbers?
- Kedar Vaze** That's right.
- Kartik Mehta** Generally we used to do a capex of Rs. 30-40-50 crore and the last year because of the inorganic and the current year maybe because of the organic capex. So, net-net around Rs. 250 to 270 crore of addition in the gross block and I understand that anyway our capacity utilization was much lesser even prior to FY17? So, what sort of a revenue kicker we might see because of this qualitative and quantitative capex?
- Kedar Vaze** Broadly put in two buckets, one is the investments on the Mahad and Anhui facilities which is around Rs. 100 crore odd. We see an uptick of about Rs. 50 crore of additional revenue on that facility and improvement in the operating matrices due to moving to Mahad which we had quantified last call or three quarters back, roughly in €2 million as a saving. So, that's something which will materialize both in top-line and bottom-line with through the Rs. 100 crore odd investment we have done. The other large investment has been in CFF, which I just mentioned that is going as per plan and we will look to consolidate those numbers in the coming years.
- Kartik Mehta** Reason behind asking this question is that though we are doing a capex but somehow your balance sheet, which used to be net-debt free has become a net debt number and of course, we understand that this capex will be yielding the



operational benefit and eventually you might generate better cash flows. But are we moving towards structurally lower asset turnover sort of a capex and eventually it may hamper our overall return ratios?

- Kedar Vaze** I don't think that is the case. You will see that like any large capex, 1 or 2 years of kind of rolling and then the revenue profitability comes in, it will normalize to the long-term average.
- Kartik Mehta** According to you, may be in a 2 years down timeframe, it should stabilize and start yielding with a company level sort of returns?
- Kedar Vaze** That's right.
- Moderator** Thank you. We will move on to the next question that is from the line of Jasdeep Walia from Infina Finance. Please go ahead.
- Jasdeep Walia** With regard to the problem that you faced with your domestic clients in the Fragrance segment, could you please elaborate what kind of clients are these, which segments are they operating in? What exactly is their problem with this GST? I'm asking because none of the consumer companies have reported this kind of trend in sales because of GST or related issues in this quarter.
- Kedar Vaze** There are two parts of it; this is pertaining to very specific segments of Home care and other sectors which were not covered by GST, for example, Coils and Agarbattis and some of the Oils etc. which were not covered by GST or by excise or other indirect tax free products and then subsequently in the GST environment, they are paying the GST on their sales and they are awaiting GST refunds.
- Jasdeep Walia** What proportion of sales do these clients make of your business in the domestic Fragrance segment?
- Kedar Vaze** On a total basis, this is roughly Rs. 75 crore revenue.
- Jasdeep Walia** Annual?
- Kedar Vaze** Annualized.
- Jasdeep Walia** What percentage of your sales in the Fragrance segment comes from Tobacco? And how has this segment been doing over the years?
- Kedar Vaze** We do not have any specific sale to these segments. We do have sales to general market and we are aware part of that goes in various products used for chewing tobacco, paan, all the various products sold at the paanwala shop. We believe it is in the range of between Rs. 125 to 150 crore.
- Jasdeep Walia** And at what rate has this business been growing over the years?
- Kedar Vaze** As a combined general market, we have been seeing 6% to 8% growth which includes this business. We don't have a separate way of tracking this because products are multi-use products.
- Jasdeep Walia** In the Flavor segment, the trend in revenues in the domestic market has been pretty subdued, so you lost the business on account of shortage of this Orange Citrus Oil. But sequentially, the business has not been growing, so I am seeing

your numbers from Q4 of FY18 to Q1 19 then Q2 and now Q3, it seems it has gone down.

**Kedar Vaze** There is actually more seasonality in the Flavor business because summer products Ice cream, Beverages kick in. So this year again we have seen a deferred sale on these products. Very big ticket large accounts, they kind of pick the material depending on a little bit seasonal variation.

**Moderator** Thank you. The next question is from the line of Rajesh Kothari from AlfAccurate Advisors. Please go ahead.

**Rajesh Kothari** My question is with reference to the raw material availability, where do we stand today? Whether the BASF plant, which was having a huge problem whether it has started supplying, can you give us some update on that?

**Kedar Vaze** The specific BASF-related force majeure, they have lifted that force majeure effectively in the last quarter. It was four quarters under force majeure. Now they have restored normal supply for most of the products, excepting one or two small products which don't majorly affect us.

**Rajesh Kothari** So, are you seeing now the raw material prices coming down?

**Kedar Vaze** In that aspect, the raw material prices have stabilized. They are not further increasing. We would hope to see some normalization —at this moment there is still a backlog of demand—so I don't see any immediate softening but the further increase in prices are not expected.

**Rajesh Kothari** I think it is very important if you can give little bit more insights into this because surely the results have been disappointing due to one or other reasons. What is the raw material inflation what you have faced on index of 100 in last two years per quarter if you can give that kind of a trend then we will be able to understand how actually the businesses are moving. Similarly, you mentioned that GST has also impacted. Now if I look at second quarter and first half then the growth was quite strong, so why all of a sudden it hits only third quarter?

**Kedar Vaze** Actually it's a combination of GST, it is also a working capital issue for the customers because their GST refunds are not coming as fast and they typically have a high uptick of sales in the Diwali season, so Festival season as they call it and they are stuck with the working capital and that's why there is deferment of schedule orders.

**Rajesh Kothari** If I look at H1 FY19, in Fragrance business, you have reported Rs. 465 crore of revenues and if I just divide it by 6 to get the quarterly revenue, it's about Rs. 232 crore and if I look at your third quarter, it is Rs. 226 crore. So, there is no big seasonality that I can see in Q3 over first half and in the first half, there was a growth.

**Kedar Vaze** You have to look at the domestic Fragrance for this, the rest of the business has done better so we are seeing less decline. The decline is actually quite steep in domestic Fragrance business.

**Rajesh Kothari** If you look at the time of IPO, during meetings, whatever guidance that you were having and there were many factors or issues which keep hitting us unfortunately. How do you see now next four quarters? Can you give us some color on next one year, in terms of segment wise within the domestic exports, how do you plan to recoup the margins and finally the earnings growth? Because on the other end also

you have a huge capex, so your interest and depreciation cost is also hitting us for the first time from Rs. 1.5 crore interest cost now we have reported Rs. 4.5 crore quarterly interest cost. So if you can give more insight that will be really useful because it is really disappointing numbers from last so many quarters.

- Kedar Vaze** I think your comment and question is valid. Rather than commenting on kind of a smaller part, we will look to present a proper guidance in coming days. So even we talked and we embarked on this primarily on the account of price increase and margin rationalization, we had to sacrifice some growth in respect of lower margin products to ensure the quality of our business is sustainable. At this point, we are in a scenario where all our businesses are in good health in terms of margin and profitability. Looking forward, we expect that a 12% volume growth or value growth across Fragrance and Flavors across all the divisions and the additional kicker of roughly Rs. 50 crore of incremental revenue through the Mahad and investments in the AID.
- Rajesh Kothari** So, Rs. 50 crore in Mahad, when do you see that will come, from which quarter?
- Kedar Vaze** This will be the first quarter next year when the facility is fully ramped up.
- Rajesh Kothari** You mean April - June?
- Kedar Vaze** April onwards.
- Rajesh Kothari** So, on an annualized basis you are saying Rs. 50 crore Mahad will add to your revenue on annualized basis, correct?
- Kedar Vaze** That's correct.
- Rajesh Kothari** And the raw material index, how have you witnessed last 2-3 years raw material index?
- Kedar Vaze** I don't have the detailed data on quarter-on-quarter. On an annualized basis, the industry has witnessed something like 25%-27% cost increase on the same weighted average basket. So, that's the kind of inflation from last year to this year.
- Rajesh Kothari** So, your inventories which you were holding, the low cost inventories I'm sure all those things now must be over.
- Kedar Vaze** That's right. So, we have undergone two cycles of price corrections, discussions with customers and we are seeing early signs of stabilization on the input cost.
- Rajesh Kothari** So, the price increase is still not happening that's what you are trying to say? Out of the domestic, when you say your Fragrance business, domestic is -20%, can you give breakup between volumes and price because price you were negotiating from last so many quarters then you are saying there are challenges and it takes time.
- Kedar Vaze** There are two parts, one is volume and the other is the gross margin and price. So, we have seen that the gross margin price has seen sort of normalization, the gross margin discussion has happened. There are certain customers, certain pockets where the volume growth has actually been negative, which is why you see this overall scenario in the third quarter.
- Rajesh Kothari** Let's assume you were domestic -20% in Fragrance business, out of that, how much is volume de-growth and how much is price de-growth or what is the breakup of that price versus volume?

- Kedar Vaze** There is approximately 6% to 8% price increase across the segment in a weighted average basis and the rest 12% is the volume growth versus last year. Last year, in Q3 FY18, the entire growth of post-GST was restored so we had a very high growth in that quarter.
- Rajesh Kothari** Last year, GST was implemented there was a major issue for GST- implementation for organized - unorganized Agarbatti type of players but then you didn't face that situation during Q3 FY18. But we are not able to understand this because that cycle cannot come only for one quarter.
- Kedar Vaze** I am not saying GST is explaining everything. The point is certain segments have de-grown substantially and it is very steep decline in the end of the quarter. So, we are still awaiting whether that is just deferment of orders, which is the current view we have with the sales and none of the business has been lost. They have deferred the sales of December and we understand a lot of them are grappling with working capital availability or liquidity issues rather than actual business growth. So, they are cutting down their growth plans based on the working capital management.
- Rajesh Kothari** So, do you think fourth quarter will be equally challenging or do you think fourth quarter is going to be better than what we have seen?
- Kedar Vaze** Fourth quarter is already better than the third quarter, a bit. We're looking at a third quarter, which is at very low base.
- Rajesh Kothari** Last year for Q4 FY18, you had Rs. 283 crore of revenue with very low EBITDA margins. So I'm saying on revenue terms, do you think fourth quarter is going to be a good year on Y-o-Y basis?
- Kedar Vaze** I think there will be growth Y-o-Y basis in the fourth quarter. I don't anticipate any specific negative in this quarter.
- Moderator** Thank you. The next question is from the line of Chirag Dagli from HDFC Asset Management. Please go ahead.
- Chirag Dagli** Can you indicate the volume growth in 9M FY19 business as a whole?
- Kedar Vaze** This year, the overall volume growth would be around 6%, which is in the exports.
- Chirag Dagli** Nine-month sales growth has been 5%. What is the split of that in volume and value.
- Kedar Vaze** Domestic is -3% volume and 7%-8% price increase and export is entirely volume increase.
- Chirag Dagli** So, volume growth of 6% in exports and -3% in domestic?
- Kedar Vaze** Yes.
- Chirag Dagli** The Mahad Ingredient facility does it have only Tonalid or other ingredients as well?
- Kedar Vaze** It does have other ingredients, but it's largely Tonalid.

- Chirag Dagli** The Netherlands subsidiary did Rs. 175 crore sales last year, post the Mahad scale up; Will this number be larger and how should we think about this year?
- Kedar Vaze** We have talked about it last time as well. PFW as a Netherlands subsidiary and the various operating facilities may be in different legal entities, but you need to look at the business as a whole. So, some of those sales will go directly from India, some will be routed through the subsidiary, depending on the nature of the contracts and the customer.
- Chirag Dagli** So, on a consolidated basis, this number that we did last year should be Rs. 50 crore plus. Is that what how we should think about this when you say Mahad adds Rs. 50 crore annualized?
- Kedar Vaze** Rs. 50 crore annualized is additional revenue. The gain in market share and additional products combined together will give us Rs. 50 crore.
- Chirag Dagli** These small customers that you talked about in Agarbatti Home Care, have these customers scaled up in January, back to normalized levels or showing some signs of going back to normal in January, when you indicate this Rs. 100 crore number, have these customers come back?
- Kedar Vaze** Typically, these businesses are more seasonal, so there is a higher off-take in the festival and post-festival, there is normally a slowdown, so we are seeing that as a normal trend this month. So, there is no specific further slowdown than the equivalent period last year.
- Chirag Dagli** This Flavor business margins have been very volatile and on a smaller base the margins are higher than the Fragrance business. Is this business fundamentally a higher margin business than your Fragrance business?
- Kedar Vaze** The disruptions in the product and the flavors has resulted in certain business being lost altogether and we have better visibility and control in the margin so it has been less disrupted by force majeure on the Flavors as compared to Fragrances.
- Chirag Dagli** But fundamentally, you don't think the two businesses have very different margins per se.
- Kedar Vaze** Yes.
- Chirag Dagli** In your opening comments, you mentioned about you being selected as the preferred vendor with some MNC. If you can share some more details around that, what does it mean in the terms of commercial basis, what does this mean?
- Kedar Vaze** Normally, whenever there is new product development, they would assign the same thing to seven or eight companies and with this preferred vendor arrangement, they would do to a restricted group of 2-3 companies as a preferred vendor. So, new developments are preferred with the selected vendors.
- Chirag Dagli** These are existing clients, where you are hoping to increase your wallet share eventually.
- Kedar Vaze** That's right.
- Chirag Dagli** Why has the interest cost gone up significantly in the quarter?

- Kedar Vaze** As I mentioned earlier, the capitalization of interest for the Mahad facility has come in since we have operationalized it in this quarter. The entire interest cost of the Mahad Investment has been charged to the P&L.
- Chirag Dagli** This is a sustainable run rate eventually?
- Kedar Vaze** Depreciation in interest at Mahad approximately is Rs. 6 crore that has been charged with this quarter and the commensurate revenue has not yet come in so if you adjust for that we are on a long-term average roughly around (+) 9% PAT on the underlying business.
- Chirag Dagli** What is happening with the Italy acquisition, why is it not consolidated?
- Kedar Vaze** It continues to be a joint venture in terms of the accounting and the agreement. There were certain covenants which needed to be fulfilled by them. We are awaiting their December audited results, post which the decision on consolidation and further steps will be taken.
- Chirag Dagli** For nine-months, this entity is completely out of the finances?
- Kedar Vaze** That's right. It's only at the profit share one line.
- Chirag Dagli** But where is that reflected, profit share?
- Kedar Vaze** As share of profit.
- Chirag Dagli** But the PAT impact, even if you consolidate would not have been very different?
- Kedar Vaze** I think the PAT impact would not be very different. The interest cost and the profit PBT calculation on the tax on that you would have to take account of that. Just to complete, there are a few covenants for which we are paying additional cost because it's still a joint venture. On consolidation, we will end up saving some of these ownership cost or management cost, which they are incurring today.
- Moderator** The next question is from the line of Keval Shah from Jeetay Investments Pvt. Ltd. Please go ahead.
- Keval Shah** Can you please explain the purpose for the recent pledging of shares?
- Kedar Vaze** As part of the promoter family, we have pledged certain parts of the share to create a line of liquidity.
- Keval Shah** Is it related to any other business venture?
- Kedar Vaze** That's not related to any other business venture.
- Keval Shah** The cash flow from operations for 9MFY19 has been around Rs. 41 crore, so there has been significant drawdown in this cash flow from operations. Can you explain reason for that?
- Kedar Vaze** Actually there is a lot of working capital movement upwards due to the price increase. Same volume of stock has gone up in value so there is some amount of the generated cash, which has got blocked in the working capital. Approximately in 9M FY19 is Rs. 70 crore - the working capital increase.

- Keval Shah** How much would be the working capital days now and compared to FY18?
- Kedar Vaze** On the same denominator of sales, it is 175 days as against 150 days last year.
- Moderator** The next question is from the line of Rohan Gupta from Edelweiss Securities. Please go ahead.
- Rohan Gupta** First question is on this revenue decline, which we have seen in the current quarter though you mentioned that there is small user industry like Agarbatti fragrance and all, they contribute not even less than 10% in terms of overall revenue but the large fall in the revenue of the current quarter, mainly in month of December is contributed to that so does it explain the fall in the revenues or have other verticals in the quarter has also been weak and the liquidity crunch or the GST related issues have affected other customers as well because it may not be explained only by that small portion, which contributes only 10% of the revenues.
- Kedar Vaze** If you look on quarter-on-quarter, typically there is some slowdown in the last quarter and there is some uptick on the International Fragrance, based on the ingredients sales, which happen. So, in this year, we have not had the full benefit of the ingredient sales going through Mahad facility, having started in the second half of the quarter and typically, we would expect post Diwali that some of the ingredients sales would compensate for the seasonal drop. These are the two major reasons that the Mahad facility sales had not been in line with the expected uptick and the Agarbatti and other certain sectors have actually de-grown in terms of year-on-year sales.
- Rohan Gupta** Mahad facility is only supposed to give us additional revenues and provide the raw material but the facility and the downstream operation was always on?
- Kedar Vaze** We have kind of moved the Netherland facility from the month of June; so there was no production and we were selling through stock and we were expecting the production to be ramped up in October-November which it has. So there is kind of deferring sales by a month.
- Rohan Gupta** Second question is on that guidance which you are talking about is roughly 12% volume growth that you are giving for FY20 but you also mentioned that there will be flat pricing. However this year itself, we have seen your input cost index has gone up close to 25%. We have yet not taken sufficient price increases during the year and in general also, when we had an earlier meeting you mentioned that in general as an entire product basket, you take close to 8% to 10% price increase every year. This year input cost increase has been more and that is putting pressure on margin but when you're guiding for next year, we are not even considering that 8% to 10% general price increase, which across the product basket you generally take so why so and given such a sharp increase in raw material cost, why won't we be able to take price increase?
- Kedar Vaze** Sharp increase in raw material has already been factored and negotiated with the customer this year in more than one time; so it is already being factored in the pricing. The expectation is that after the steep increase on last 4 or 5 quarters, there will be slight easing and if you take average 5%-6% cost increase, you will see some amount of decline on the products that have seen hyper-inflation. So, on a total basket, we expect it to be very close to zero.
- Rohan Gupta** You are saying that over the next 6 months, the prices actually will come down and that's why the input prices or end product prices wherever you have taken some price increase, will also come down to their customer?

- Kedar Vaze** Not to that extent, because we have not got the full impact of the price increase from the customers, so, on an average if I take the two years, it would be 12% per annum and we would have got some part of that but we see that trend is flat or downwards on some of the products, which had a large increase last year. So, we have normalized our pricing models on the basis of the average expectation for next year.
- Moderator** The next question is from the line of Pritesh Vora from Mission Holding. Please go ahead.
- Pritesh Vora** My question is with respect to your market share; how do you compare yourself with IFF and other players and do you operate in the same market or do you operate in different market?
- Kedar Vaze** We do operate in the same market. We have certain markets where they are not our direct competition. In other markets, they are our single or significant direct competitions. So, we are present in all the segments in larger Global MNCs to the smallest accounts in India. We are comparable with them in the market. Their presence in the global MNCs is much larger than our presence.
- Pritesh Vora** So, what is the competitive advantage we have got vis-à-vis with them, how do we compete them?
- Kedar Vaze** If I can take an often-repeated market statement, "it's winning in many Indias" is where our competitive advantage comes. We understand "Many Indias" better than global companies and we are able to tailor-make consumer products which are better suited for those consumers.
- Pritesh Vora** If we want to divide the market between the large customer, medium customer and a smaller retailer or customer, what percentage of revenue comes from each of this bucket?
- Kedar Vaze** This is the kind of a divided issue, take the domestic customers into five groups and we see that the top A,B,C, top three groups consistently account for almost 65% of our revenue and the D&E are the remaining 35%.
- Pritesh Vora** Which gives a better margin- is it the DE or ABC?
- Kedar Vaze** When you say margin, that is the raw material and operating cost. At the smaller customer, you have higher operating cost and a better gross margin. In the larger customers, you have less gross margin but net operating costs are also per kilo lesser, so in the end, the beauty of our business model, built over so many years is that, we are really to operate profitability-wise in the same range in all these sectors.
- Pritesh Vora** Another question was in respect to inventory. In total working capital cycle, your inventory days are almost double than the global measures like IFF and others. So, what are you doing to improve on inventory and why your inventory is almost double the days of other major manufacturers?
- Kedar Vaze** The problem with the comparison is that the disruptions, the ease of doing business in India, the logistics, the entire structure of most of the emerging markets is quite different. Almost 80% of our business is in emerging market, whereas only 40% to 50% is in emerging markets for these larger companies. In more developed mature markets, your ability to get the forecast and to have the prediction and supply chain organization is better and you can therefore get better optimization of

inventories. In addition, depending on the sales trajectory and the opportunities that we see, we are buoyant to see a large growth in specific products and we need to keep the inventory as an opportunity cost.

**Pritesh Vora** I can understand if the inventory level is 20%-30% higher than others but you are almost double than others, so is there any room for improvement, going forward. Is it purely raw material inventory, is it work in progress or is it the finished good?

**Kedar Vaze** There are different business models in terms of inventory holding versus inventory warehousing with third parties and so various models of contract and if you take interest cost overseas, they are very low. In that scenario, they prefer to use third-party vendors to stock inventories and do a JIT kind of arrangement. In our specific case, we are keeping all inventories for future.

**Pritesh Vora** Is it that you cater more SKUs than them in terms of unique products, how many SKUs you have?

**Kedar Vaze** In terms of SKUs we believe, I do not have the full details of SKUs level of the competition but in terms of average estimate, we would have at least four to five times the SKUs of most of our competitors.

**Moderator** The next question is from the line of Pallavi Deshpande from Smart Karma. Please go ahead.

**Pallavi Deshpande** What percentage of your Tonalid requirement will be met by Mahad? And how much would be exported versus used domestically?

**Kedar Vaze** 100% of our own demand will be met by Mahad. As Tonalid is a global product, roughly 10% of the consumption of this product is in domestic market in India and 90% continues to be outside India. That is the broad breakup of this product.

**Moderator** Thank you. Ladies and gentlemen that was the last question. I now hand the conference over to the management for their closing comments.

**Kedar Vaze** Thank you. I hope we have been able to answer your questions. We also take some of the suggestions in terms of proactively informing and few other things that are noted by our team. Should you have any need for any further clarification so would like to know more about the company, please feel free to contact our team or CDR India. Thank you once again for taking the time to join us on this call.

**Moderator** Thank you. Ladies and gentlemen on behalf of S.H Kelkar and Co Ltd. that concludes today's conference. Thank you for joining us and you may now disconnect your lines.