"Shankara Building Products Limited Q3 & 9M FY-19 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Q3 and 9 months FY19 Earnings Conference Call of Shankara Building Products Limited. This conference may contain forward looking statements about the company which are based on the beliefs, opinions and expectations of the company as on the date of this call. These statements are not the guarantees of future performance and involves risk and uncertainties that are difficult to predict. As a reminder, all participants' 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. Siddhartha Mundra – CEO of Shankara Building Products Limited. Thank you and over to you, sir.

Siddhartha Mundra: Good morning everyone and a very warm welcome to our Q3 and 9 months FY 19 earnings conference call. Today I am joined by Mr. C. Ravikumar – Executive Director, Mr. Alex Varghese – Chief Financial Officer and Strategic Growth Advisors – our Investor Relations Advisors. We have uploaded our updated results presentation on the exchanges, and I hope everybody had an opportunity to go through the same.

Our consolidated revenues grew by 14% for 9 months FY 19 and the retail segment grew by 28%. We are progressing well on our key business focus areas. We are progressively reducing our channel business, we are also rationalizing our processing business, we continue to stay strongly focused on our balance sheet.

On the retail side – the retail segment now contributes to over 55% of our overall revenues for Q3 and 53% for the overall revenues for the 9 months. Our retail margins stood at 9.4% for 9 months and 7.9% for the Q3. The channel business has been de-grown and now contributes approx. 14% of our overall revenues. The channel business de-grew by 16% for the 9 months on Y-o-Y basis.

Our processing business has been unstable for the last couple of quarters with volatile steel prices and a tough operating environment. These lower processing margins also had an impact on our margins across our retail, enterprise and channel segment. We are addressing this situation through a number of measures:

- Firstly, we are rationalizing our production volumes, we are doing this with two objectives – some of the product categories which are not viable for us are being pruned. Further, higher production volumes also build in higher inventories to the system. By reducing our production volumes, we look to address both these issues.
- We are looking to stem the shortfall in our own products through higher purchases of third-party products.

- In addition, we have adopted various cost control measures across the company to reduce our overhead expenses especially on the processing side of the business.
- Our employee costs and other overheads have gone down by around 10% in the last quarter.

A lot of these measures were initiated in December and the follow through positive effect should continue in the coming months. The overall business transition process of reducing processing and channel business is strongly underway. Our headline debt numbers including acceptances have fallen by Rs. 23 crores from Q2 FY 19 to Q3 FY 19. We are also concentrating on reduction of debtors by encouraging higher cash sales. Our debtors as on Q3 FY 19 stands at Rs. 343 crores as compared to Rs. 418 crores at the end of Q1 FY 19. We are further trying to delink the need for additional working capital to grow our business by tying-up with finance partners who will provide funding to our customers for purchases through us. In this context you would have seen a few board approvals that we have taken for supply chain finance in this quarter. The supply chain finance works in two ways; one is in which a supplier is the anchor. The corporate guarantee approvals that you would have seen are for this program. The other program is where Shankara is the anchor. In this program the finance provider funds the suppliers as well as customers of Shankara. This is done on the basis of transaction history of these parties with Shankara. We believe that this program is a unique differentiator for Shankara compared to our largely unorganized competition. It builds stickiness with our customers as this formal finance may not be easily available to many of them. Further, the finance companies' ability to assess and provide funding would be far higher than what Shankara's balance sheet can provide. This helps our customers to scale with higher availability of funds. This also helps Shankara in selling more to the customers. We have been working on it for some time and we look to scale this program in the next few quarters.

New product categories continue to be our key focus area. We have further intensified efforts on the customer connect program. Over the last 3 months, we have conducted over 50 influencer meets reaching out to over 1000 influencers. Majority of these meets have been attended by our brand partners.

Now focusing on the quarterly performance of the company:

The total revenue for Q3 FY 19 stood at Rs. 605 crores as against Rs. 625 crores for the corresponding quarter last year. Revenue for 9 months stood at Rs. 2,034 crores as against Rs. 1,788 crores for 9 months, a growth of 14% on a year-on-year basis. EBITDA for 9 months stood at Rs. 103 crores as compared to Rs. 121 crores last year. EBITDA margins stood at 5.1% in 9 months as compared to 6.8% in the same period last year. Steel price volatility would have impacted our profitability by around Rs. 10 crores in the last quarter. PAT stood at Rs. 31 crores for 9 months with a margin of 1.5%.

Now focusing on the segmental performance of the company:

The retail sales saw a growth of 28% in 9 months to Rs. 1,079 crores versus Rs. 842 crores for the same period last year. 9-month EBITDA grew to Rs. 101 crores, up by 12.6% from Rs. 90 crores same period last year. Retail EBITDA margins stood at 9.4% for 9 months. The contribution of retail to total revenue stood at 53% for 9 months and 55% for Q3. As on date we have 134 stores of which 116 stores are on a lease basis. The total area of the stores comes to around 5.65 lakhs sq. ft. with an average store size of 4200 sq. ft. The average rental cost for leased outlets stood at Rs. 19.1 per sq. ft. per month. Average ticket size was around 28,500 for 9 months FY 19.

A large part of our retail business is steel or steel-linked. The steel price volatility in the last quarter has impacted our retail business. Steel prices fell by around 5% between Q2 to Q3. A falling price scenario also leads to the postponement of purchases by our customers. In this environment we have planned to consolidate our retail revenue mix and reduce dependence on steel pipes. We are also encouraging cash sales which may cause some losses in sales. We are adding to our product and people capabilities in this phase. Our new product categories grew at around 10% for the quarter. Comparable sales growth stood at 12.1% for 9 months FY 19. After two quarters of parallel reporting of same stores sales growth numbers as per two methodologies, we have transitioned only to the new methodology. The same stores sales growth number as per the earlier methodology stood at 21.5%. Of the total retail sales, construction material constitutes around 61%, interior-exterior around 20%, the newer product category is around 14% and agricultural products around 5%.

Enterprise sales for 9 months stood at around Rs. 638 crores up by 12% compared to same period last year. It now contributes to 31% of the consolidate revenues. The channel sales stood at Rs. 317 crores for 9 months, down 16% compared to the same period last year. This segment now constitutes 14% of the overall revenues of the company. This decrease is in line with our overall approach to reduce revenues from this segment.

On the processing side – the processing margins stood at 2.3% for this quarter. This decline has impacted our margins on an overall basis. As mentioned earlier we have taken certain measures to address these issues and the impact would be visible in the coming months. We continue to be focused and committed on our long-term objectives as we have already outlined while continuing to tread on a financially prudent path.

With this I open the floor for discussion.

Moderator: Thank you very much sir. Ladies and gentlemen we will now begin the question and answer session. The first question is from the line of Maulik Patel from Equirus Securities. Please go ahead.

Maulik Patel: Few things, first if you can give the data on what has been the processing revenue this quarter?

Siddhartha Mundra: Yeah it is around Rs. 353 crores.

Maulik Patel: How much?

Siddhartha Mundra: 353.

Maulik Patel: And processing sales volume approximately?

Siddhartha Mundra: 58,000 tons.

Maulik Patel: Second is that on the SSG you have given on a 9-month basis. What could be the SSG for this quarter?

Siddhartha Mundra: It has been largely flattish.

Maulik Patel: So should I take it as…is it 1%, 2% or it is…?

Siddhartha Mundra: Yeah just under…it is around (-1%).

Maulik Patel: Third point, you mentioned about this financing arrangement. If you can take it little more detail and are there any recourse on either side of these arrangement to the Shankara's balance sheet?

Siddhartha Mundra: See as I had mentioned earlier, there are two aspects in which the program works. There is a program in which one of my suppliers is an anchor and there is another program in which Shankara is the anchor. The corporate guarantee part is relevant to the part where one of my supplier is the anchor. So if you think about it you know, this was a payment which was anyway had to be made, right? It is the corporate guarantee, I think, you know, it is more for the comfort of the finance provider to provide an additional level of assurance to the supplier. The more relevant part is where Shankara is the anchor and where we tie-up with the finance provider to say that these finance providers will now provide funding to our customers as well as to our suppliers. In this program there is no recourse on us.

Maulik Patel: Okay. And when you mentioned that your customer is essentially which kind of which is a contractor or the channel part of business? Which business are you going to target?

Siddhartha Mundra: It could be across, it is mostly likely going to start with the channel and the enterprise part of the business. But we are also looking to take this as a first stepping stone and take it to all parts of our business.

Maulik Patel: Okay. Last question is when I met you last time you discussed about this challenging processing business particularly the structural steel and there is a competition coming from the unorganized segment, particularly the billet- scrap to billet to the tube part of the business where some new capacity addition has come up. If you can update on that what exactly is the update on that and how long this trend will continue? And we also trying to focus on the precision tube part of the business, so how long it will take?

Siddhartha Mundra: See, as we have already mentioned earlier in our earlier discussions as well as in the opening remarks earlier, that we are taking measures now to reduce certain of our production volumes. There are certain product categories in which we are better off buying from our other suppliers than manufacturing it in house. So that is the process that we have already started and the cuts have already happened. So that is something that we are already doing and trying to ensure that our processing business continues to stay healthy.

Maulik Patel: But is that the competition is still prevalent the margins has become so low which you have also mentioned it in the presentation, are there any improvement? Because recently what we heard that the steel prices are inching up, it is higher now.

Siddhartha Mundra: Right.

Maulik Patel: So, will that improve our margin profitability because you mentioned that the steel prices were going down, customers were not buying and there was a part of the operating deleverage also came into the picture.

Siddhartha Mundra: See Maulik, in the current operating context there are certain production calls that we have taken and there are certain productions that we will not be doing. That is the call that been taken for our Hyderabad and for our Bangalore facilities. If the situation in the market improves we will be nimble to react to that situation. As of now we have taken those cuts.

Maulik Patel: So, is this 58,000 volume which you have mentioned, it can go down further from this level?

Siddhartha Mundra: Sorry could you come again?

Maulik Patel: The production volume mentioned 58,000 tone approximately, right?

Siddhartha Mundra: Yeah, it could come down further also.

Maulik Patel: And what could be that level, if just for in a modelling purpose we need to build that.

Siddhartha Mundra: I think it is a moving number as of now we can possibly take it later.

Moderator: Thank you. The next question is from the line of Karthikeyan VK from Suyash Advisors. Please go ahead.

Karthikeyan VK: Continuing on the previous line of questions, just a couple of things. One is could you explain, again just for the record how receivables occur in the retail part of the business and the other part of the business. Could you give us some perspective on that? And how does the channel financing piece help you in that?

Siddhartha Mundra: Sorry I didn't understand the question.

Karthikeyan VK: I said what percentage of your receivables that you reported Rs. 343 crores would be on the retail side of the business and how does that originate, meaning what compels you to give credit? So just trying to understand that, and when will channel financing help you overcome that need, to what extent rather?

Siddhartha Mundra: See, the retail part of our business there are lot of influencers and SMEs that we supply to. So these are regular, repeat purchaser that we have which have been built over a period of time. The retail business operates in a context where our competition also provides credit. So for us to continue to do business for these customers we need to provide credit to these customers. The customer in addition to credit, is also looking for a wide range and availability of products which is where Shankara scores. So that is the operating context. In terms of the debtors we have possibly around Rs. 150 crores of debtors on the retail side.

Karthikeyan VK: Right. And channel financing eventually you hope will take care of this requirement. Is that how to understand that?

Siddhartha Mundra: Yes, so it is not that you know, all of this will move into channel finance immediately. The channel finance partner itself will do an independent analysis of these customers and depending on its own assessment will look to provide credit facilities to these customers. But what we feel is that this is something that is possible only with an anchor like Shankara in this otherwise really unorganized segment because, the core aspect of this program is regular transactions and the confidence and the trust that this finance partner can place in terms of these ledgers of transactions that the anchor will share.

Karthikeyan VK: Right sure. The other thing you said is that SSG was a negative number for the quarter, right? (-) 1 or something to that effect?

Siddhartha Mundra: Yeah.

Karthikeyan VK: Right, could you give us some perspective of why that would be so, how much of that was because you scaled down operations? And how much of that was because the market environment was weak? Just to understand.

Siddhartha Mundra: See as we were saying earlier that, steel price volatility continues to have an impact in terms of the way our purchasers purchase. Some of these purchase decisions can be put off by our customers anticipating price certainty and price stability. So that is an aspect that impacts us. Further there are other aspects especially in the steel pipes side where certain of our sales were not becoming very competitive and we are also looking to scale down some of those sales. So that has also impacted our overall sales growth.

Moderator: Thank you. The next question is from the line of Dhaval Shah from Girik Capital. Please go ahead.

Dhaval Shah: Just need one information. What is the breakup between channel and enterprise sales?

Siddhartha Mundra: Channel and enterprise what?

Dhaval Shah: Revenue from channel and revenue from enterprise.

Siddhartha Mundra: Okay, so for the quarter the retail revenues were say, Rs. 334 crores and for channel was Rs. 86 crores and enterprise was Rs. 185 crores.

Dhaval Shah: 185?

Siddhartha Mundra: Yeah.

Moderator: Thank you. The next question is from the line of Pritesh Chheda from Lucky Investment Managers. Please go ahead.

Pritesh Chheda: Sir any reason why we don't make money on the non-retail part of the business?

Siddhartha Mundra: No, we do make money.

Pritesh Chheda: So when you look at the EBITDA number, there is no EBITDA number on the non-retail part of the business.

Siddhartha Mundra: Yeah, so as we had mentioned that, that part of the business that we are consciously looking to scale down, that is where our overall ability to match pricing in terms of credit as you know, over a period of time eroded. And that progress on that reduction has been continuing over the last many quarters and we continue to focus on that. That part of the business is also more tightly linked to our processing part of our business. 80% of sales of channel and enterprise are actually our own products. Any impact on processing directly impacts channel and enterprise margins. And that is what you see in terms of **flow through** margins on the reported numbers.

Pritesh Chheda: So 80% of the production is consumed in house?

Siddhartha Mundra: 80% of channel and enterprise sales is our own products.

Pritesh Chheda: Okay our own products, and in this Rs. 343 crores of debtors that you reported in Q3, how much is linked to retail business and how much is non-retail?

Siddhartha Mundra: Retail was the number that we just mentioned was around Rs. 150 odd crores.

Pritesh Chheda: 150?

Siddhartha Mundra: Yes.

Pritesh Chheda: And lastly, you know we went into this taking cash discount from the creditors by buying immediate. However, there is still reduction in gross margins. So one data point that highlighted was that you wanted to run a slightly more business, if you recall your past two quarters. Now I am seeing no SSG coming, so if growth was the reason why you took the cash discount and passed on, then ideally the growth should have come. So which part of the link is missing actually?

Siddhartha Mundra: Yeah, so we operate in a fairly volatile and an ever changing environment. Two data points may not be able to provide the exact picture. As we have already stated, steel prices have been very volatile in the last couple of quarters. Steel price movement and steel price decline especially leads to the postponement of purchases from customers. We have also consciously tried to de-focus from steel pipes, certain product categories in steel price, which are not as remunerative. So that has impacted our overall sales growth.

Pritesh Chheda: How much is steel as a percentage of retail revenues?

Siddhartha Mundra: Around 80-85%.

Pritesh Chheda: Of your retail revenues?

Siddhartha Mundra: Yes.

Pritesh Chheda: So, but you gave a very…

Siddhartha Mundra: Steel or steel linked.

Pritesh Chheda: So you gave a breakup as construction material 60%, interior-exterior 20, new products 11 and agriculture 5.

Siddhartha Mundra: Yeah.

Pritesh Chheda: In this 80% is steel or steel linked?

Siddhartha Mundra: Yes.

Moderator: Thank you. The next question is from the line of Hiral Desai from Anived Portfolio Management Services. Please go ahead.

Hiral Desai: Just on the processing business. So you know, from our past interaction I believe we started the business in 2010. So that is a 8-year history of the business so when was the last time you had seen this kind of volatility in the steel prices? And why didn't we see this coming towards the end of the year? Because I think the guidance that you guys gave on the retail margin at the end of the last year was still at about 10%. And then if I just look at the steel prices the data that I have which is the HRC Mumbai prices, you know broadly if I look at averages there has been a 3-4% move sequentially, which you know I thought for a commodity of that nature is you know fairly recurring. So I am still not able to understand you know, why we could not see something like this coming?

Siddhartha Mundra: There are two aspects to this, one is the steel price movement itself. The other is the underlying price in steel pipes which is a derivative of the steel HR coil. The steel price itself has fallen from Rs. 46,800 in October to Rs. 45,800 in November to Rs. 43,300 in December. So there has been a continuous kind of a decline over these three months. The decline in steel pipes have happened in a much sharper trajectory as compared to the basic coil. We started this business in 2010 on the processing side, in fact we have been in this business for about 4 decades now more on the steel side. This is something that, at least we feel internally has been a quite difficult operating period, especially for us. I understand that we should have possibly prepared ourselves better and anticipated this. But we have possibly not been able to do so and for that we are taking corrective measures now. We have as we have stated earlier, we are reducing our processing business, we have already instituted cuts, we have also cut down our operating expenses in this part of the business. So we are trying to take measures to ensure that this does not recur.

Hiral Desai: So do you feel that if the steel prices were to recover from here the processing business will have much better performance going ahead? Because we typically have only about one month of inventory so I am still struggling to sort of join the dots on why there is so much of pressure on the profitability. And the same is applicable to your peers also, right? So they also operate in a very similar dynamic, volatile operating environment.

Siddhartha Mundra: No actually see I think what happens for us is that we have a one-month exposure on the processing side and then we carry forward another month of exposure on the sales side you know, through our warehouses and through our retail outlets. So net-net our exposure actually you know, doubles from one month to two months.

Hiral Desai: Okay. And the other is for the processing facilities there are I think already some corporate guarantees which are existing on the balance sheet as of you know, annual report of 2018, and in the past we have discussed that we had processing separately because there were some regulatory issues with respect to taxation. So is there a thought of merging the processing back into the stand-alone business?

Siddhartha Mundra: No as of now there is no thought process. At least to my mind it is better to have these separated because the processing which is more CAPEX heavy kind of a business it is better to have that in a separate balance sheet and a more retail and trading kind of a business which Shankara currently is to have that in a separate balance sheet. It is debatable whether three subsidiaries should be one but as you would be aware that is how the business evolved. Vishal was acquired in 2010 and then Taurus which was earlier a part of Shankara because of taxation issues had to be subsidiarized and we also then acquired Century as an acquisition. So that is the way that the corporate structure has evolved.

Hiral Desai: And when we were starting some of the new products on retail we were fairly confident that the steel and the construction material was actually our forte, and actually a very strong piece within the entire Shankara story. Now what has happened you know, in terms of the margins of the steel? Do you still hold on to the fact that you guys understand the business well?

Siddhartha Mundra: We continue to believe so. I think that will only be exemplified by performance, I don't know what to answer to that.

Hiral Desai: No because the only reason is you know as investors sitting outside looking at a retail business which will you know eventually end up making 6-8% margin with so much of volatility translates the entire thing more into a commodity trading business versus a retail business. So that is the only observation that I would I have.

Siddhartha Mundra: The data point that I would like to add is that our retail business on a stand-alone basis is a very low working capital business. The challenge comes in because there is as of now an extension of the working capital cycle which is happening, because you have a processing part of the business also in which you have raw materials and finished goods which is lying in those units. In fact, if you look at it what has possibly saved us in the last quarter is our retail business. Because otherwise the impact of steel price would have been much-much sharper. The fact that we have a very large distributed set-up and in hinterland, actually it protects us from those fluctuations.

Hiral Desai: And given that the financing bid that you guys do on retail is sort of spread across a few states. How will the channel finance guys be able to evaluate the origin as of the debtors?

Siddhartha Mundra: These are fairly large guys actually with all India set-up except possibly in North East. I think they have a fairly large set-up across locations, and it depends on one's hunger for business and growth as well. So I'm assuming that they will be hungry for growth.

Hiral Desai: And there is no recourse in case you know, any of these guys default or anything?

Siddhartha Mundra: No, that is not how the program is planned as of now.

Moderator: Thank you. The next question is from the line of Naitik Modi from OHM Group. Please go ahead.

Naitik Modi: Could you please give me the breakup of retail sales in terms of non-steel and steel for Q3 and for 9 months?

Siddhartha Mundra: For Q3 we said it was 14%...

Naitik Modi: Of the retail sales?

Siddhartha Mundra: Yes.

Naitik Modi: Okay and for 9 months?

Siddhartha Mundra: Yeah, it is around 12.5%.

Naitik Modi: Okay, and could you give me a sense of what will be the gross profit margins in the non-steel products in the retail segment?

Siddhartha Mundra: It will be around between 8%-10%.

Naitik Modi: Okay. And how has been the category growth of plumbing & sanitation? Because we have been focusing on that category.

Siddhartha Mundra: Yes, so it has been good. We have grown at around 10 odd percent as is the SSG equal in number between Q3 to Q3.

Moderator: Thank you. The next question is from the line of Abhishek Ghosh from DSP Mutual Funds. Please go ahead.

Abhishek Ghosh: What are the inventory losses in the current quarter due to fall in steel prices?

Siddhartha Mundra: Around Rs. 10 odd crores.

Abhishek Ghosh: And would there be further this thing in the current quarter also?

Siddhartha Mundra: See January also has been a difficult month. In fact, between November, December and January, January was the steepest fall. So let's see how this quarter shapes up.

Abhishek Ghosh: Okay, and sir in terms of the own product, what is the percentage of own products in this current quarter for Q3 FY 19?

Siddhartha Mundra: It is around 58%.

Abhishek Ghosh: 58%?

Siddhartha Mundra: Yeah.

Abhishek Ghosh: Okay, and the corresponding margins are about 2.3% for that, right?

Siddhartha Mundra: Yes.

Abhishek Ghosh: Okay, and what is our outlook on the retail store addition for FY 20 now?

Siddhartha Mundra: See as of now we will concentrate on the current quarter at hand. We will possibly discuss this on the next quarter call.

Abhishek Ghosh: Okay fair, and do we hold onto the margin guidance which we had kind of laid out on 30th November call of 6 to 7% kind of retail segment margin? Do we kind of hold on to that or are you kind of reassessing that as well?

Siddhartha Mundra: No, we continue to hold onto that.

Moderator: Thank you. The next question is from the line of Saumil Mehta from BNP Mutual Fund. Please go ahead.

Saumil Mehta: Sir first when I look at the non-steel sales in the retail business while you know we have been focusing on more store addition and you know increasing our focus but when I look at the other category growth, be it you know the entire exterior-interior portfolio what we have, the tile, sanitation, the growth trajectory in those category growth has been much faster. So where are we missing in terms of increasing our share in the overall retail portion when it comes to the non-steel portion? Because it looks like for the past few quarters that number seems to have you know stuck in a ranged bound.

Siddhartha Mundra: So there are a lot of things that we're working on. As we have said, there is number of upgrades, a number of product additions, and number of relationships building exercises on our customer side, on our supplier side that are happening. This is a business which will mean that your purchase behavior has to change from the existing sources to new sources. This habit changing behavior will take a bit of time. Having said that, we continue to be very focused, very strong and very positive on growth prospects in this part of the business. Definitely growth can be faster and we hope next year will be much faster than what we have done this year.

Saumil Mehta: Fair point. But you know what I am failing to understand is that as you mentioned the gross margin in that part of the business is pretty strong so ideally the focus should be less and less of steel where volatility is there. But you know, somehow that is not translating into actual numbers that we report. So, you know, I mean, is there internal a lot of reshuffling which has happened in terms of foreseeing or you know, what is actually the reason for the lower growth in the non-steel part when it comes to the retail business?

Siddhartha Mundra: No, from a position where we were only a steel-based company to have come to where we are, we feel that we have treaded a very long path. Definitely the journey ahead is also you know, quite long and there are growth opportunities for us. But for us to have started this transitioning process and you know reach where we are itself at least to our mind is fairly reasonable first level achievement that we have done. Definitely there are opportunities for growth and we continue to focus on that.

Saumil Mehta: Second is when it comes to you know, margins for our own products, now I understand there will be certain inventory losses but even after adjusting that inventory losses, I think the margins for our own products itself is maybe at best case 3%, is that a fair estimate?

Siddhartha Mundra: That is what we have been doing in terms of pruning our product portfolio now. There are certain products which are low margin and which we would want to now cut, which process has started in December, which should accentuate in this quarter and that is a call that we have already taken so hopefully the results should start showing in this quarter.

Saumil Mehta: But assuming that those products should be a large part of these channel business where you know, we are actually being de-focusing. So, I'm assuming with the incremental de-focusing on channel, the overall margin profile should look better because that will have more sales in the enterprise business. So you know, what I want to understand is over the next 2-3 years what should be the margin territory for own products in the non-retail business?

Siddhartha Mundra: I think we are currently in an unstable environment, possibly we can discuss that in the next quarter.

Saumil Mehta: Okay fine. And in terms of the total interest cost what we have for this quarter and for 9 months what is the fixed charge what we pay for getting some of the facilities?

Siddhartha Mundra: The fixed charge would be around Rs. 14.5 crores for the quarter.

Saumil Mehta: Rs. 14.5 crores for this particular quarter?

Siddhartha Mundra: Yeah.

Saumil Mehta: And the total debt what we have as on September was sorry…?

Siddhartha Mundra: September was Rs. 340 crores.

Saumil Mehta: 340, so the average interest cost what we pay even excluding the fixed charge is about 13.5-14%?

Siddhartha Mundra: No, as we have mentioned earlier there are certain acceptances on which there is a cost payable which comes in our finance charges.

Saumil Mehta: Okay.

Siddhartha Mundra: Acceptances as end of September was Rs. 189 crores.

Saumil Mehta: Okay so it is about Rs. 540 odd crores with the acceptance numbers?

Siddhartha Mundra: Yes, Rs. 530 crores as on Q2 and Rs. 507 crores as on Q3.

Moderator: Thank you. The next question is from the line of Dhaval Shah from Girik Capital. Please go ahead.

Dhaval Shah: We must have had some inventory loss in the quarter, correct?

Siddhartha Mundra: Yeah.

Dhaval Shah: So now that is reflected where? So is it divided between some in retail some in channel enterprise, so in which number it is getting reflected?

Siddhartha Mundra: It is through the system.

Dhaval Shah: Sorry?

Siddhartha Mundra: It is throughout the system, right.

Dhaval Shah: Yes! Exactly so now say for example, if the channel and enterprise, now margins are at 1.1% so now this is not normalized margins. How much is due to like inventory loss in this?

Siddhartha Mundra: You can assume an equivalent revenue split also or the other possibly better way would be to do it in the ratio of the inventory. So 30% of the overall inventory is sitting in retail and 70% is sitting in channel enterprise. 30% in retail and 70% in channel.

Dhaval Shah: Okay, so the manufacturing margin is captured in channel enterprise?

Siddhartha Mundra: No, in retail as well.

Dhaval Shah: Okay. So what do you think will be if the inventory loss was not there and you did the same volume so how much margin would we have made?

Siddhartha Mundra: We would have made possibly around Rs. 10 crores more.

Dhaval Shah: Sorry?

Siddhartha Mundra: I mean this is just an estimate I mean please don't….

Dhaval Shah: Yes, the rough number.

Siddhartha Mundra: Yes, Rs. 10 crores.

Dhaval Shah: Okay so the Rs. 3 crores EBIT would have been Rs. 13 crores?

Siddhartha Mundra: Correct.

Dhaval Shah: Okay, and so now this channel business which we are planning to reduce so how many more months do you think it will take like, to reach almost like negligible level?

Siddhartha Mundra: It would take possibly a year or so.

Moderator: Thank you. The next question is from the line of Deepak Poddar from Sapphire Capital. Please go ahead.

Deepak Poddar: First I wanted to understand basically in our retail sales how much institutional sales is included in our retail sales?

Siddhartha Mundra: What do you mean by institutional sales?

Deepak Poddar: Like…

Siddhartha Mundra: We still do SMEs as well through our retail outlets.

Deepak Poddar: Yes, so how much would that share be?

Siddhartha Mundra: We don't have a ready number for that, possibly we can come back to you.

Deepak Poddar: Okay, and sir you have mentioned in the past as well like in terms of raw material passing it will take about a year, right? For you to pass on the entire kind of increase that you have seen to the enterprise or the channel network, right? So one year is what, you still believe it would take time for you to completely pass it on?

Siddhartha Mundra: Yes.

Deepak Poddar: Okay, and so post that a channel enterprise EBITDA margin of 3-5% is what you still maintain kind of, we would kind of look at?

Siddhartha Mundra: Yes.

Deepak Poddar: Okay understood, and in terms of growth can you give some light on the growth that we're looking at separately for retail as well as channel enterprise separately over next maybe 1-2 years?

Siddhartha Mundra: We can possibly take up in the next quarter.

Deepak Poddar: Okay sure.

Moderator: Thank you. The next question is from the line of Andrew Peretti from Macquarie. Please go ahead.

Andrew Peretti: I just want to ask for your 5 stores in Goa what would be the percentage of revenues for those stores please in Goa.

Siddhartha Mundra: Sorry I didn't get your question please?

Andrew Peretti: The percentage of revenues for your stores in Goa, I believe you have 5 stores in Goa. Could you just tell me what is the percentage of revenue would be?

Siddhartha Mundra: The percentage of revenues of our Goa stores, is it?

Andrew Peretti: Yes, please.

Siddhartha Mundra: 4%.

Andrew Peretti: 4% okay thank you and the mix between steel and non-steel in those in some of the small states, i.e., that would be the same as a year ago business saw in retail?

Siddhartha Mundra: Goa will still be largely steel linked only though we have started upgrading our stores there but largely, as of now they are steel linked.

Andrew Peretti: So the refurbishments happening are they across all the stores or how many stores would you say for refurbishment not just in Goa but across the business?

Siddhartha Mundra: We are looking at 2 upgrades in our Goa operations.

Andrew Peretti: Okay, and then across the business how many stores would be being refurbished?

Siddhartha Mundra: See we have around 65 of our stores which are in various phases of upgrades where we have expanded our product categories.

Moderator: Thank you. The next question is from the line of PVS Sreekanth from Spark Fund. Please go ahead.

PVS Sreekanth: I just wanted to know you know, as a percentage of total company sales what would the component of steel and steel related products be?

Siddhartha Mundra: See, for retail it is around…

PVS Sreekanth: No, I got that number but totally as a percentage of total…

Siddhartha Mundra: Channel enterprise is largely steel or steel linked only.

PVS Sreekanth: So is it fair from that number can I say that it is around about 80-85% of total company sales would really comprise only steel and steel related products?

Siddhartha Mundra: Possibly a tad higher.

PVS Sreekanth: A tad higher? 85-90% of total company sales. So I was just wondering if I take a particular item in this steel and steel related products space that you all are merchandising and if I look at how it is peddled through one of the three channels either retail or channel or enterprise, would the gross margins or the realizations on that particular item be very different from channel to channel?

Siddhartha Mundra: Yes, they will be different.

PVS Sreekanth: Why would that be? Because at the end of the day it is essentially commodity, right? So you're telling me that if I come to the shop it will be at a much higher cost for the consumer than if I were to buy it through enterprise or channel?

Siddhartha Mundra: No, the difference is that the nature of the customer is different in all the three segments. In the case of channel, there is another dealer and another retailer who is the customer. In the case of retail, it is actually an end customer let's say, a small contractor or a small fabricator or a small SME who is the customer. In the case of enterprise, it is possibly a larger enterprise or a larger end user which the customer. So the nature of the customer is different in all the three aspects.

PVS Sreekanth: Understood, and so you're basically saying you wouldn't really vent to a small customer in the enterprise or the channel side and that would be because of a minimum ticket size?

Siddhartha Mundra: Yeah, I think the approach itself is different. This is more direct kind of an approach where we have sales teams which look into the enterprise side of the business while the retail is more done through our retail outlets and cater to geographies which are closer to the retail stores. So the approach to business itself is very different.

PVS Sreekanth: Okay. So besides your processing business the output is captively consumed by the retail and enterprise channels, you are purchasing on a bought out basis a lot of steel and traded items?

Siddhartha Mundra: Yes.

PVS Sreekanth: And would the margins on those be lower obviously than what it would be for a processing margin?

Siddhartha Mundra: Yeah I mean, in the normal scheme of things possibly a year back that would have been the statement to say. But what we have realized especially in the last couple of quarters that our own products are at times priced higher than what we can buy from third-party suppliers.

Moderator: Thank you. The next question is from the line of Harshil Gandhi from the line of JHP Securities. Please go ahead.

Harshil Gandhi: Sir just wanted to know whether there are any plans to hive off the retail division.

Siddhartha Mundra: As of now there are no plans.

Harshil Gandhi: So in medium-term?

Siddhartha Mundra: I mean, as I said there is no plan as of now.

Moderator: Thank you. The next question is from the line of Jaspreet Singh Arora from Systematix Shares & Stocks. Please go ahead.

Jaspreet Singh Arora: Just a clarification, you mentioned the 80% contribution from steel, that is largely channel enterprise. In the retail and what was the figure you mentioned?

Siddhartha Mundra: Yeah around 80-85%.

Jaspreet Singh Arora: So it is exactly the same in both.

Siddhartha Mundra: No. So that is what we said, that in the retail part it is 80-85%, and in the channel and enterprise it is largely steel, or steel linked.

Jaspreet Singh Arora: So what does largely mean? 95%?

Siddhartha Mundra: It will be higher; it will be at a company level, it will be higher than 80%.

Jaspreet Singh Arora: Okay. I was just checking my old notes, I mean I saw figure of 60% in FY 16, so am I right I mean is that number right? We have basically gone up, the steel portion from 60 to85% in the last three years?

Siddhartha Mundra: No, I think in fact we have come down. I don't know that 60% is more on the construction materials side.

Jaspreet Singh Arora: Okay.

Siddhartha Mundra: That might have been the number that you would have noted.

Jaspreet Singh Arora: Okay fair. In the profitability margin of 1.1% or let's say Rs. 3 crores in channel & enterprise, is it possible to break it up between channel & enterprise?

Siddhartha Mundra: No it is not possible.

Jaspreet Singh Arora: Or is it fair to understand I mean, again from my old notes you make about 1-2% margin in channel so enterprise is largely negative and primarily coming from that inventory loss, is that a fair…?

Siddhartha Mundra: Might be the other way round, the channel business will have lower margins as compared to enterprise.

Jaspreet Singh Arora: But I am saying for the quarter if you continue to make a 1% margin on channel where typically you should not be making losses because end of the day it is CNF, right? So on an enterprise because there is inventory loss so it is negative for the quarter while the channel continues to be positive. So at an aggregate level you have 1.1%.

Siddhartha Mundra: Yeah, inventory loss is on account of both – both the segments and there is an operating cost also to do those sales.

Jaspreet Singh Arora: Sure but in the channel part there would not be any inventory loss it is largely in enterprise, right?

Siddhartha Mundra: No it would be in both, right.

Jaspreet Singh Arora: Okay. And the processing margin would you have that Q3 last year number, if you can share of processing margins compared to 2.3%.

Siddhartha Mundra: Same quarter last year was 4.5%.

Jaspreet Singh Arora: Okay so the drop is about 2.2%?

Siddhartha Mundra: Yeah.

Jaspreet Singh Arora: Sure, and what has been the quarterly data that we have is only pertains for the last 3 quarters. What is the lowest that would have been even in the processing margins in the last couple of years that you would have observed?

Siddhartha Mundra: In the recent history this has been the lowest.

Jaspreet Singh Arora: Can this be the bottom for the year and probably for the coming few years given that you know, the measures that you are taking to correct this, or it is still sometime away before you can give that outlook with confidence?

Siddhartha Mundra: No, I feel that a lot of the measures that we have taken will have a positive impact. But they will take some time to follow through, some of the things have started only in December. We see in that the follow through impact will continue during this quarter. But hopefully Q4 the operating costs will be lower than Q3 for the processing side.

Jaspreet Singh Arora: Sure, and just lastly when you said the exposure on the processing side is about one month on inventory and again there another month on the sales. So essentially you are saying it is the time-lag between you know when you have the inventory for on the steel side and that is in a month and another month when you have the finished product. So you have total two months exposure on the finished goods stock, raw material side while sales have not yet happened and therefore any case the prices have gone down you will essentially be selling on spot and while all the inventories on a higher prices and therefore you end up with a loss, is that a fair assessment?

Siddhartha Mundra: Yeah, so what has happened is that steel prices generally change on a monthly reset. As long as we can ensure that we are closer to that one-month kind of a number in terms of our inventory holding we should largely be okay.

Jaspreet Singh Arora: So historically has that number is in the change and this one month on the exposure on each side processing and sales, let's say in Q3 and let's say in the past couple of years have we been able to bring it up?

Siddhartha Mundra: Yeah it has gone up in the last few quarters it has gone up.

Moderator: Thank you. The next question is from the line of Siddarth Raj from JHP Securities. Please go ahead.

Siddarth Raj: Sir just wanted to have the number of stores which we have refurbished till now having all our products including sanitary ware and other products?

Siddhartha Mundra: We can come back to you with the specific numbers. But around 65 of our stores are in the upgrade process. Possibly there will be around 40-45 stores which will have the sanitary ware and the tiles and the fully expanded range of products.

Siddarth Raj: Okay, and I missed the gross margin numbers which you gave sometime back of non-steel products in the retail channel.

Siddhartha Mundra: Yeah?

Siddarth Raj: I missed that numbers. Can you please repeat that?

Siddhartha Mundra: Yeah 8-10%.

Siddarth Raj: And sir, on store addition side, currently there is no expansion plan, right sir?

Siddhartha Mundra: We definitely, in the long-term we definitely we have expansions and we have ambitions to grow this network. For the time being in the immediate near term we are looking to consolidate the stores that we have already put up and look into focus on the new products.

Siddarth Raj: Okay, sir we would be one of the largest distributors for many of the products I think now because we have the largest chain, 134 stores and also reach to many cities. So does it give us some negotiation powers in our suppliers? And can you quantify something, if yes?

Siddhartha Mundra: It does over a period of time, there is benefits which can be more direct commercial in nature in terms of higher margins, turnover, discounts etc. There are lot of other at a field level and at a discussion level with these partners, there can be many other kinds of benefits that can also come through which could be in terms of better field co-ordination, better utilization of resources across organizations, coordinated marketing efforts. So lot of these things are other hidden benefits that come through with scale.

Siddarth Raj: Okay but difficult to quantify.

Siddhartha Mundra: No, it is difficult to quantify the hidden benefits

Siddarth Raj: Okay sir. What will be our cash and credit sales at retail share?

Ravi Kumar: On an average it is 50%.

Siddarth Raj: 50% cash and 50% will be credit?

Siddhartha Mundra: Yeah.

Siddarth Raj: So sir we are actually doing per close to 3 lakh worth of sales per day per store. So close to 1.5 lakh worth of cash so how do we ensure that there are no leakages at any end? Because there is lot of cash that is generated at every store.

Siddhartha Mundra: When we say cash this is not necessarily physical cash. When we say cash it could be in terms of credit card swipes, it could be in terms of RTGS, NEFT, cheques, any electronic medium. Physical cash will be possibly let’s say around 5% or even lesser.

Siddarth Raj: Okay, and sir the product that I see most of those products we would not be doing any bar-coding kind of thing because it is not being visible so what are the processes that are set in so that there is no theft or by the employees nothing can be done by them? Anything on that sir, the system that you have?

Siddhartha Mundra: So we have multiple levels at which we ensure that this is done. We have an internal audit team which keeps doing an assessment of inventory on all the locations on a periodic basis. We also have an external-internal audit team which also supplements these efforts. The ultimate responsibility of inventory lies with the store manager and there are penalties that could be imposed on the store manager in case we find there is laxity in inventory control. So there are means and measures that are in place to take care of that.

Siddarth Raj: Okay sir. And we have acquired some stores recently. Can you say what was the EBITDA margin before acquisition and where has it reached now? Any broad numbers sir?

Siddarth Raj: These were acquired around a year back. So what we acquired was JP and Vaigai. Vaigai was almost an EBITDA breakeven kind of situation and Vaigai was around 6 odd percent. Both of these currently are trending around that 9-10%.

Siddarth Raj: Okay sir. And can you please give me some guidance on the current industry outlook means, largely we are construction material focused so on the industry construction industry demand?

Siddhartha Mundra: See the industry outlook is to my mind buoyant and positive. It depends on us you know, how we can capture the opportunity the market is large. As of now the movement does not immediately impact us in terms of ability to grow because the headroom for growth is very high.

Siddarth Raj: And sir can we assume that the current quarter is a new normal for us?

Siddhartha Mundra: That is something that we also would like to believe, given the measures that we've put in place to address the situation. But let's discuss again kind of next quarter.

Moderator: Thank you. The next question is from the line of Rahil Jasani from ICICI Securities. Please go ahead.

Rahil Jasani: Sir in the previous earnings call you mentioned that the processing volumes were around 80,500 in Q1 and 72,000 in Q2 which has come down to around 58,000 you mentioned in Q3. So that is around a 27-28% decline from Q1. I'm sure that is seasonality, but can you tell me what is the issue of low margin products which you are looking to reduce in this processing volumes, and how much further do you look to reduce the processing volumes?

Siddhartha Mundra: See there a certain product category within our production mix which are in the current environment not remunerative for us. So we are better off buying of these products rather than doing it in house. So that is what the focus that we have brought in. We are reducing our overall processing volumes to match pricing realities in the market. And that is the context in which this production cuts have happened.

Rahil Jasani: Sir I understand that but just seeing what is the ratio of that product say even in the current quarter volumes of 58,000. What can we expect further after trimming down of the low margin products?

Siddhartha Mundra: We can come back to you and we can discuss this in the next quarter.

Rahil Jasani: Okay sir but the trimming down will happen from this quarter right?

Siddhartha Mundra: It has already started.

Rahil Jasani: It has already started, okay sure.

Moderator: Thank you. The next question is from the line of Saumil Mehta from BNP Mutual Funds. Please go ahead.

Saumil Mehta: So the Rs. 10 crores inventory loss can you split that between the enterprise channel and the retail business or is it entirely into enterprise and channel business?

Siddhartha Mundra: The loss, the inventory split between the segments would be 30% would be in our retail part of business and 70% in enterprise and channel. So possibly that would be a ratio which you could use to allocate.

Saumil Mehta: Okay and in the press release and the number what you mentioned is the total segment profit before interest and tax. So I just want to make sure it is not the EBIT this is the EBITDA number right?

Siddhartha Mundra: This is the EBITDA number absolutely. The segment profit is EBITDA.

Moderator: Thank you. The next question is from the line of Harsh Pathak from ICICI Direct. Please go ahead.

Harsh Pathak: Sir just wanted to seek clarity. I mean, firstly you mentioned about the steel and steel product contribute close to 85-90% of the overall revenues. And secondly if I'm looking at the processing revenue which is Rs. 355 crores on a base of 605, it is close to the 58%. So, and then what would be the difference between 85 to 58%?

Siddhartha Mundra: Those are what we procure from third-parties.

Harsh Pathak: Okay it is a third-party product. So our inventory loss exposure would be restricted to our own manufacturing not on the third-party right? Is it correct understanding?

Siddhartha Mundra: That would be a fair understanding yes.

Moderator: Thank you. The next question is from the line of Vallabh Patil, an individual investor. Please go ahead.

Vallabh Patil: For the last year what would be the element of inventory gain in Q3 as well as FY 18?

Siddhartha Mundra: We don't have the number handy for that but we can get back to you. From what I can see in terms of pricing data for the last year these were largely flat. So I don't think that there would have been any gain or loss for the same period last year.

Vallabh Patil: Okay and sir FY 18?

Siddhartha Mundra: I am talking about FY 18 only.

Vallabh Patil: Okay great. And sir the entire year, FY 18 I mean?

Siddhartha Mundra: See for us what matters is sharp movements. If it is gradual ups and the gradual downs our inventory gets reset to the new normal or to the new pricing. When there are sharper movements that is when it becomes an issue.

Vallabh Patil: And of the total debtor breakup of Rs. 343 crores, which would be more than 6 months?

Siddhartha Mundra: More than 6 months as of Q2 would be around Rs. 20 crores net of provisions.

Moderator: Thank you. Ladies and gentlemen as there are no further questions from the participants I would now like to hand the conference over to Mr. Siddhartha Mundra for closing comments.

Siddhartha Mundra: Thank you everyone for joining us. I hope we've been able to answer all queries. In case you require any further details, you may please contact us or our investor relations adviser - Strategic Growth Advisors. Thank you.

Moderator: Thank you very much sir. Ladies and gentlemen on behalf of Shankara Building Products Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.