June 03, 2021

To
The Manager
The Department of Corporate Services
BSE Limited
Floor 25, P. J. Towers,
Dalal Street, Mumbai – 400 001

Scrip Code: 539450

To
The Manager
The Listing Department
National Stock Exchange of India Limited
Exchange Plaza, Bandra Kurla Complex,
Bandra (East), Mumbai – 400 051

Scrip Symbol: SHK

Dear Sir/ Madam,

Sub: Submission of transcript of conference call under Regulation 30 of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015

Pursuant to Regulation 30 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, we are enclosing the transcript of Q4 & FY 21 Earnings conference call for investors and analysts organized by the Company on Friday, May 28, 2021 at 02:00 PM IST.

You are requested to take the same on record.

Thanking you,

Yours faithfully,

For **S H Kelkar and Company Limited**

Deepti Chandratre
Company Secretary & Compliance Officer

Encl: As Above

S H Kelkar & Co Ltd
Q4 FY21 Earnings Conference Call Transcript
May 28, 2021

Moderator: Ladies and gentlemen, good day and welcome to S H 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 S H Kelkar and Company Limited's Q4 & FY21 Earnings Conference Call. We have with us Mr. Kedar Vaze – Whole-time Director and Group CEO and Mr. Shrikant Mate – VP and Group CFO of the Company.

We would like to 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. Kedar Vaze to make his opening remarks.

Kedar Vaze Good afternoon everyone and thank you for joining us on our Q4 and FY21 earnings call to discuss the operating and financial results of this quarter. I trust that you and your families are safe and maintaining all precautions against the spread of COVID-19.

To begin with, I am pleased to share that we have delivered a healthy performance driven by the normalization in demand enquiries across both domestic as well as international markets during the quarter. We saw improved client engagements and new wins across the domestic FMCG space. This supported the full year performance in FY2021, which was otherwise affected on account of pandemic-related disruptions in the first quarter of the year. Our CFF business also delivered strong results on the back of increasing demand and volume off-take in the Italian and other European markets.

Overall, on a consolidated basis, the total revenues from operations during FY21 grew by 19% on a year-on-year basis and on a like-for-like basis, revenues grew by 3% year-on-year, without adjusting for the period of disruption. On the profitability front, our prudent inventory management in addition to better product mix enabled us to maintain margins at a healthy level despite the global supply chain and raw material inflation issues, particularly in the second half of the fiscal. Our gross margins during the year stood at 43% and EBITDA margins were at

19%. During the quarter, gross margin stood stable at 42%. It is encouraging to note that in the last eight quarters, we have consistently delivered steady gross margins within the range of 42% to 44%. This indicates our business model's financial efficiency and stability. Reported PAT during the year stood at Rs. 143.7 crore. Excluding exceptional gain and loss in FY21 and FY20, respectively, PAT in FY21 stood at Rs. 131.2 crore as against Rs. 71.2 crore in the previous year, higher by 84% year-on-year.

From a consolidated balance sheet perspective, we were able to significantly lower our net debt by Rs. 112 crore during the quarter owing to robust collections, strong cash flows and normalizing inventory. It translated to a healthy debt to equity ratio of 0.4X. Going forward as there are no major CAPEX plans on hand, the focus remains on healthy free cash flow generation. We should be able to further strengthen our balance sheet position in the upcoming fiscal.

Coming to our business development:

I'm happy to share that in the month of April 2021, our wholly owned subsidiaries Keva Italy and CFF acquired 70% equity stake of Nova Fragrance S.r.l. Nova is an Italy-based company specializing in fragrance development and marketing with specific focus on premium customers and high-end products, particularly in hair care and beauty care. This is a value accretive and synergistic inorganic growth opportunity for us and is in sync with our growth strategy to expand addressable market in Italy and Europe.

In another development, S.H. Kelkar has now become the exclusive distributor for Isobionics' product Santalol in India The new fragrance ingredient is the first joint product from BASF and Isobionics and is now available for the Indian market through SHK. The new fragrance ingredient is an alternative to sandalwood oil and is produced by a biotechnological basis from renewable raw materials. We look forward to improve momentum through this product.

On the demand side, while we are witnessing healthy wins across new and existing customers, the environment in the ongoing quarter has soften on account of the second wave of COVID-19. We are monitoring the situation closely and are undertaking all precautionary measures to mitigate business risks. Our key focus area remains on steadily growing our business and maintaining margins within the healthy levels. We continue to look at the new fiscal from a growth perspective and will reassess the situation by end of this quarter. Our engagement with clients, especially in the domestic FMCG segment remains strong and we are registering steady wins across all categories. This should enable us to sustain our growth momentum going forward.

Before we close, I would like to share that the Board of Directors at the meeting held yesterday recommended a dividend of Rs. 0.75 per share in addition to the interim dividend of Rs. 1 per share announced in November 2020. For the full year FY2021, the overall dividend would be Rs. 1.75 per share. It keeps in view the Board's philosophy of conservative cash management and its focus on preserving liquidity in the Company, given the unprecedented operating environment that we all face.

On that note I would now request the moderator to open the forum for any questions or suggestions that you may have.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Rohit Nagraj from Sunidhi Securities.

Rohit Nagraj: My first question is in terms of our business; so, during the pandemic year, we have seen that probably some of the lower ends of the businesses have not performed well or partially gone out of business. So, has it affected market share in the domestic market and have we seen some kind of a change from the unorganized to organized, which has helped us in the domestic market?

Kedar Vaze: In domestic market, across all categories, we have maintained our market share vis-à-vis the overall FMCG fragrance and flavour. There is no particular category or client type which has done better or worse. In the initial part of the year, the smaller clients in certain sectors such as deodorants and premium products did not do very well but they caught up in the second half of the year with the pent-up demand and the destocking that had taken place in the first quarter of the year. On a full year basis, we have managed to maintain our market share across all categories in the domestic market.

Rohit Nagraj: The second question was in terms of debt reduction. We have reduced the debt sizably despite that we are maintaining significant cash on our books. So, is it probably to again engage in some inorganic initiatives or is it just to safeguard from any COVID-related disruptions that we may have?

Kedar Vaze: So, as a part of business continuity risk management, last year, the Board had mandated us to increase the cash holdings at various bank accounts, which we are operating in the region. We will review that post pandemic and bring down our free cash held in balance to reduce the overall cash in the balance sheet.

Moderator: The next question is from the line of Ujjwal Shah from Quest Investment.

Ujjwal Shah: Just wanted your view on the growth ahead for FY22, considering 2nd wave of pandemic. Can you throw some light on the guidance for FY22 in terms of revenue as well as margin?

Kedar Vaze: I think we have a very peculiar situation, where we are in the midst of a pandemic where there is a large uncertainty. So, I would not venture to give a year's guidance. Obviously, Q1 FY22 is softer than the previous quarter. It is already almost two months of the quarter and we are seeing some softness in this quarter. For the rest of the year, if I extrapolate from last year, I would imagine that from the second quarter, our growth rate should resume to the average 12% YoY growth that we have in the underlying business that we do. I do not see anything from the pandemic last year or this year, which has affected our market share or future growth prospects. We continue to grow in all our categories. Our clients and brands have done exceedingly well in this year, despite the pandemic, although it was sporadic. So some brands and products did not do well in the first half of the year, they picked up in the second half of the year. Likewise, we anticipate that this year will be a year of mixed bag. But I would not venture to give guidance. On the longer-term, we maintain our (+12%) CAGR growth guidance on a 2-3 years' horizon. But where we will end up this year, it is difficult to fathom that at this point. Through the year as business environment changes post pandemic, we will give a proper guidance and update to the community.

Ujjwal Shah: But in terms of margins, do you think the level of margins that we are doing right now can be maintained ahead?

Kedar Vaze: We have been quite prudent in our inventory and as the prices have been going up, we have accumulated additional inventory. We will pass on the additional cost increases to our customers as far as possible. I think there will be some transient margin pressure, may not be very large but maybe one odd month or one odd

quarter, we may see some decline. But in the long-term, the full year basis, the gross margin will continue to maintain the trajectory of around 42% to 43% level.

Ujjwal Shah: Europe has been opening up quite well. So, your views about CFF for the year ahead and secondly what are our plans for Nova considering it is a high gross margin business? So, what is the management looking forward to in terms of Nova acquisition?

Kedar Vaze: The general environment in Europe is, as you mentioned, improving, it is ahead of the curve in terms of COVID and vaccination. We anticipate by July-August, that most of Europe will be fully open and back to normal business. As such our business in CFF has not been negatively affected by the pandemic even last year or this year. We continue to see good growth across all the categories where we are operating. With the addition of Nova we are also able to go to additional clients which were not accessible to CFF in the past. The acquisition of Nova,a marketing and development company, fits in the manufacturing setup that CFF already has in Italy. It is also an Italian company based out of Milan. So, it is very easy to operate seamlessly and merge the management teams of these two companies. We anticipate the incremental growth of Nova. We already have some inter-company sales to Nova from CFF. Netting off for that, we should end up with about 1.7 to 1.8 million of incremental sales due to the acquisition of Nova.

Ujjwal Shah: In terms of margins because Nova operates at very high gross margins generally.

Kedar Vaze: In terms of margins, Nova product range is in the premium Haircare, Beauty products. It is at the higher end of the margin profile. Within Europe, the consolidated core business margin of CFF is around 53%-54% gross margin level and with the addition of Nova, which is slightly higher at the ballpark 58%-59% gross margin. Last year numbers of Nova was even better because of the reduction in the raw material prices in the interim mid-year. I think on a healthy basis, it will be on the higher end, around 58%-59% gross margin level.

Moderator: The next question is from the line of Viraj Kacharia from Securities Investment Management Ltd..

Viraj Kacharia: How has the CFF business grown in FY21 and vis-à-vis the market growth, say in Italy and just add to that, what would be the share of say Fine Fragrance now for the business? How has that moved for us in last couple of years?

Kedar Vaze: The CFF growth rate has been in excess of 8% organic in the core business in last 15 odd months. The underlying business growth in Italy has been around 1%-1.5% industry growth. So Nova and CFF together have grown at 8% to 9%, 3 to 4 times faster than the average market in Italy. Going forward, we anticipate we will continue to grow at a healthy pace of a roughly 10% per annum in CFF-Nova combined entities.

Viraj Kacharia: What is driving this higher growth for us? Because the market itself is growing at slower pace, is it we are getting traction in other European markets?

Kedar Vaze: In terms of perspective, the Italian market is as large as the Indian market. So, it is quite a sizable market, CFF is among the top 2 or 3 companies in the market share in Italy. We look at it as a good platform for us to build further growth in Italy and then from there on to other countries in Europe. The market size of Italy is quite large, the per capita consumption of Fragrance and Flavours is quite high.

Viraj Kacharia: In terms of the additional market share which we have gained how is the mix in terms of the customer base there? Is it largely big FMCG players or regional players?

Kedar Vaze: Yes, so again it is a very similar positioning point and customer type from what we have in India. We are largely dealing with a few businesses, largely with the regional Italian brands. And there are the brands which are working and growing in the market. We have good relations and good customer engagement with them for multiple years.

Viraj Kacharia: Second question was on if we look at our overall financials, we have this line-item intangible assets under development written-off. So, if we look at last 3 years, we have been adding up around say Rs. 15 to 20 crore of expenses every year. What are these towards? What is the write off towards and how should we understand this particular expense going forward?

Kedar Vaze: Actually, it is what we call a CWIP. So, in a write-off in turn of capitalization, there is additional capitalization in terms of the R&D projects in pipeline. I think at this moment we are more or less in a steady state. We are writing off some of the projects that did not complete or did not materialize into sales. And at the same time, we have new projects where there is a work in progress. If you look into the overview the kind of balancing number in the balance sheet is ballpark Rs. 20 crore, which is fairly steady state.

Viraj Kacharia: So, asking because earlier this expense write-off was not really there, 3 years back so just in last 3 years, we have seen good amount of expense or written-off so I am trying to understand how should we look at it?

Kedar Vaze: The policy of this has changed from the accounting year, I think, 2016 when the Ind-AS came in. That is when this policy change was made. This is now 3 years down the line, there will be write-off and there will be additions and there should be very small net difference in a typical normal year. Other normal R&D projects are running for anywhere between 12 to 18 months. We keep them capitalized in the balance sheet and when they are actually materialized, either they are successful in which, they get into capitalized asset, intangible asset. If they are not successful then they will get written-off. Ballpark this is quite steady state so in terms of what is written-off and what is capitalized on new projects, it will not result in any additional costs or deferment of cost.

Viraj Kacharia: This will basically keep on?

Kedar Vaze: Basically, it is like a rotation because the projects are longer than 1 year. These are some of the expenses of last year get written-off this year, some of the expense of this year get capitalized and will get written-off next year. Now that it has been in place for 3 years, it is kind of a steady state. There will obviously be some quarters up and down, but it is pretty steady state scenario. The projects that were initiated last year, some of them will get written off and some of the projects will get initiated this year. So there is sort of cost carry forward in the picture and then cost brought back. So, net-to-net there is no impact on the P&L.

Moderator: The next question is from the line of Jainis Chheda from Dimensional Securities.

Jainis Chheda: I just wanted to understand the long-term outlook for the company. How are we headed and what is the 5-year story for the company since there is no CAPEX plan? So how do we move forward from here?

Keva

Kedar Vaze: As I have alluded earlier, we have done sizeable CAPEX in the past 3-4 years and prior to the IPO as well. We are now looking at a maintenance growth business, where we have sufficient capacities and we are looking to continue to grow the business with the capacity utilization and value upgradation of our current product mix. We are planning for a normalized 12% CAGR growth in the next 2 to 3 years and this will automatically slowdown in terms of cash flow and profitability growth as we grow our operating size vis-à-vis the CAPEX and the operating leverage kicks in. As we continue to grow, our operating margin should slightly improve and we will then focus on continuing to work with the markets, which are the 3 markets of Europe, India and South East Asia, where we are currently operating.

Jainis Chheda: What will be your current capacity utilization, and can we have a breakup in terms of Flavours capacity utilization and Fragrances capacity utilization?

Kedar Vaze: Fragrance capacity utilization is around the 55% mark. Flavours is also around the 50% mark. We have capacity at China plant, which is also available for further expansion for us. And we continue to invest incremental investments to enhance the capacity. We do not need any large CAPEX for increasing the capacity, so within kind of Rs. 3-4 crore investments, we will be able to increase our capacity by 20% to 30%.

Jainis Chheda: In terms of margin, I suppose you will move towards more value-added products. What will be the margins, going forward?

Kedar Vaze: I think incrementally we have indicated that our current 42%-43% should go up to 45% in a 5-year period. As part of our product mix, this margin profile should improve.

Jainis Chheda: And in terms of EBITDA?

Kedar Vaze: We will manage around a 19% to 20% EBITDA margins, which is the current year level. We will maintain it at that kind of glide path.

Jainis Chheda: So the increased gross margin will not flow to EBITDA in next 5 years and plus we expect the other expenses will not grow as faster?

Kedar Vaze: They will be partly other expenses and partly R&D expenses, which we will incur for future growth. As we get margin expansion, we will also need to continue to invest higher on the R&D. If you go back 2 years, we have gone up from 1%-1.5% R&D to sales ratio to 5.5%. We brought it down to 4% and depending on the market growth opportunities, we will look at improving the R&D expenditure to the relevant growth areas. In case there is no specific R&D targets, then we will obviously increase our bottom-line EBITDA percentage but typically our expectation is to focus on future growth and continue to invest on growth keeping steady state 20% EBITDA level for the business. And incremental gains, we would like to invest back in faster growth rather than more margins.

Moderator: The next question is from the line of Bharat Sheth from Quest Investment.

Bharat Sheth: Going ahead, I mean particularly in Personal Care, which is a part of Fragrance business, where the consumer calls for transparency and traceability is increasing and people are looking for more of a sustainable product. What exactly we are doing to grow in that line and show that is a little more of premium category?

Kedar Vaze: Personal care is largely products like hand wash and soap. It is not one of the premium categories; more or less beauty products, Fine Fragrances are more

Keva

premium category as far as Fragrances is concerned. There is obviously safety and regulation, which we are all following at the moment. We do not see any challenge on that basis for our company going forward. Whenever there is a demand from the clients or consumers in terms of product declaration, safety declarations, and so on and so forth, we are following all the norms and we are focused on giving transparent, reliable, and proper product information to our clients and consumers.

Bharat Sheth: Coming to this entry into this large FMCG MNC entity. Now with Nova and CFF under our control, how do we see that opening up the gate for our company sourcing from India?

Kedar Vaze: No there is no impact of CFF and Nova in terms of the global MNC although with the fact that we have some of the global MNC headquartered in Europe and we have a local access with our office. But as such the addition of Nova or CFF does not change our position for the supply to the global MNC. We continue to do our long-term research programs and engagements with them as before. And if anything, CFF and Nova has slightly enhanced their position by having a local office in Europe, but it does not change our position on the business power.

Bharat Sheth: We have been working last couple of years to get an entry into global MNC in India. So, were we able to make some kind of an inroads or if you can give some more colour on new client addition during the year?

Kedar Vaze: In the context of that, we do have some inroads into the global business within India, particularly last year and again this year due to the pandemic, we are largely focusing on current clients and new businesses with the existing clients. With the global MNCs, our engagement in this period has been lower than previous periods. As I alluded earlier, it is only a matter of time. It is not so much driven entirely in our control.We will continue to offer our help and continue to work with the global MNCs as they develop their local brands and regional supply chain strategy.

Bharat Sheth: With this marketing of BASF-Isobionics product and with BASF having their own presence in India, whether that can be helpful for us? What is the underlying market size?

Kedar Vaze: The sandalwood oil, as you probably know, is a very unique material from the Indian forest products. Typically, sandalwood oil takes 15-16 years of the tree growing to a certain size and then there is a potential de-forestation and risk of scarcity or we effectively need to cut trees to make sandalwood oil. With that in mind, we have worked with a company in the Netherlands called Isobionics and we have made this product called Santalol, which is the main key ingredient of sandalwood oil. This allows the usage of sandalwood oil in a more sustainable manner, where it is made from bio-technology and renewable resources without de-forestation or cutting down the sandalwood trees. This is the primary objective for bringing this product back to the market. In terms of business size, sandalwood oil market is in excess of Rs. 100 crore a year. There is a good opportunity but what we see is that having a renewable source with a stable supply will encourage the use of sandalwood oil again in perfumery, which has been declining in terms of volumes year-on-year and as the volumes continue to grow, we will see the net effect of the business in helping us to grow into the premium and upcoming natural based products that is the new trend. It is helping us to distribute this product to revive the natural product which is now in short supply or in scarcity. And there is a lot of know-how within the company and in the industry for using sandalwood oil, which we are also seeking to revive as an additional leg for growth.

Bharat Sheth: You said that this has been developed by us jointly with these Isobionics?

Keva

Kedar Vaze: Yes, we have been working with Isobionics via our PFW R&D team. Isobionics, a Netherlands-based company, has been taken over by BASF but we continue to keep our relationship and manage this product.

Moderator: The next question is from the line of Anish Jobalia from Banyan Capital Advisors.

Anish Jobalia: If we have to adjust for the CFF growth in the last 3 quarters, we have done 13% odd so in line with what we have been guiding of 12% growth and if we look at before that, our growth was in the 5% range. So, would you be able to give some colour on say, the top 3-4 things which have improved our growth? What gives you confidence of the 12% growth going forward?

Kedar Vaze: We have had many years of double-digit plus growth in our portfolio and business. The 5% CAGR actually was a result of the dual effect of demonetization and GST, where lot of smaller clients' businesses actually de-grew and net effect for us was a declining business in certain sectors and certain categories, which resulted in a lower growth rate in these years. From FY19-20, we are seeing that we are back on the normal growth levels since the smaller clients where there was effect of GST, demonetization that has kind of flown through and the base of this customers has reduced from a roughly 20% to approximately 10% in FY19-20. With the new customer base, which is most of the large and medium sized FMCG in India and overseas, we are continuing to grow at a steady double-digit growth and it is not a new phenomenon. The de-growth of certain category was actually a phenomenon, which was specific to those peculiar large changes in the tax structures and other macro effects. Now that we are in a normal environment, we are able to continue to grow. Our larger customers are still growing at more than 12% maybe even around the 15% CAGR in the last 2-3 years and we anticipate that this growth will continue. Between the smaller customers growth and larger customers growth, the larger customers have been growing faster in these last couple of years and we see this trend evolving and also, we anticipate a good level of new, what I would call, modern age start-up FMCG products to come up in the next 2-3 years, which will help us further get a growth in the regional markets.

Anish Jobalia: What are some of the new developments that are there in the company which can help us grow beyond 12% say after next 2-3 years?

Kedar Vaze: We have obviously the Italian acquisition which will help us to grow in that market. That will assist us to take new markets. We have continued to invest in our product development sales and marketing in South East Asia, Middle East markets to further enhance our growth. Within the domestic market, we anticipate that the overall market should grow at 7% to 8% and 12% to 13% will be our market share growth. If there are some new opportunities which come, we will take it up in terms of global MNC business and other opportunities but the 12%-13% underlying business growth is what we anticipate and we will manage to continue to grow that within our current portfolio customers.

Moderator: The next question is from the line of Dipen Sheth from Crystal Investment Advisors.

Dipen Sheth: I have two questions. One on the margin expansion that is visible during the year. What I can see from your consolidated summarized P&L statement on Page #5 of Presentation and I checked your results vis-à-vis exchange as well, the EBITDA margin expansion of almost 450 bps on a YoY basis for FY21 is accompanied by almost no change in gross margins because your raw material expenses have risen around 19% in line with your top line. Now I do understand that while it is unfair to look at a 1-year phenomenon, I want to understand that whether this is something that is likely to change in view of what is happening and how do you see the fact that you actually cut down other expenses by almost 1% given the year?

What would the heads in those expenses which you could cut down even as you resume business?

Kedar Vaze: On the expense rationalization, we have cut down on our R&D expenses by 1% as alluded earlier from 5.5% to 4% As we continue to grow, we will re-invest in R&D for the future growth. For the balance, in terms of gross margin management, we are managing the inventories in a manner that we are selling basically to our clients from stock-in-hand so that in case of any large input changes, we try to pass it on to our clients with a 2-3 months lag. If you see this year, we had some margin hit in the Flavours, particularly in the last month of the year but the price increases and the normalization of the raw material in Flavours has already happened. We anticipate the gross margins should restore even in Flavours and that might add some small 0.2% improvement in gross margin. At the same time, there may be some new inflationary pressures on many of the bulk solvents and there is always a creeping inflation, when oil prices are going up slowly, there will be effect of that eventually in the chemicals, quantitative or the supply of the stocks for our industry. Eventually, we anticipate a 7% to 8% inflation to hit us this year on an average. And we look forward to passing this onto the clients at various stages step-by-step to manage our gross margin in the 42% to 43% range.

Dipen Sheth: Certainly, from a forward-looking perspective, you do not see gross margins as being a big lever in our margin expansion game?

Kedar Vaze: The gross margins that we have is a net effect of the product types. So, the gross margin for bulk products is lower and for speciality category is higher. Our average is around 42-43% and we are talking about 4,000-5,000 different products. It is not that one product or new product introduction is going to change the nature of the business. It is all incremental. When we say 0.5% improvement, we are talking about introducing new products at a 52%-53% may be 55% gross margin and that size of business it takes 5-7-10 years to grow to a meaningful size. Effectively, I think the gross margin expansion is not an immediate lever. It will play out over a longer term if you take 5 year or 10 years' horizon.

Dipen Sheth: My second question is with respect to how you report EBITDA and EBITDA margin. I can see that you have included Rs. 23.5 crore of other income for the year in your top line. As I can see that there is a very large jump in this year on things that are not really recurring. There is a foreign exchange gain and export contracts which happened, but you can also go into foreign exchange loss and then again, there is a big jump in one head called "other" under the other income category, from Rs. 6 to 13 crore, can you elaborate little bit on that?

Kedar Vaze: Some of these are regular incomes and this is a result of our hedging policies in terms of foreign exchange. When you look at the overall impact while there is impact of the foreign exchange gain, these are largely forward premiums sort of gain, so they are booked, and we are not dependent on any speculative price or currency fluctuation. So, each of our activity is totally hedged and this is the incremental benefit out of hedging of foreign exchange. With our imports and exports and the European business, we are largely internally hedged from foreign exchange input and output and we use banking financial hedges to ensure that we have a fixed rate, for which we have the foreign exchange gain. So, this is not expected to be a one-off gain because of certain reason, this is instituted in the policy and unless there is something majorly changing, this would be a normal feature of our cost structure.

Dipen Sheth: I am not sure how this can be recurring but anyway and the other part of other income, which went from Rs. 6 to Rs. 13 crore?

Shrikant Mate: This includes roughly Rs. 4 crore of provisions, which are no longer required which are returned back. In that sense, it could be non-operating but there is some or the other provision because the closing of quarter or year involves estimation and therefore, there is a write back, that is Rs. 4 crore and there is interest largely Rs. 3 crore, which is from the tax refund. That is non-recurring, those are two big ticket apart from the other sale of scraps etc.

Dipen Sheth: Once you review your requirement of cash that you have to keep on the books, would you rather retain the debt on the books or distribute some of the cash?

Kedar Vaze: So, you know earlier we have reviewed the position of cash given the uncertainty in the last year and even at the moment. While the total amount of cash looks quite large, it is distributed over various operating regions, so it is a consolidated quantum. So, we would like to keep 1 or 2 months of fixed costs and some lever and buffer for the working capital and so on and so forth. Mindful of the uncertainty last year that was very acute, we have now increased our overall holding. I think we can review that and reduce the cash carried and repay some of the debt on the OD's or otherwise at this point.

Moderator: The next question is from the line of Ravi Purohit from Securities Investment Management Private Limited.

Ravi Purohit: Most of my questions have been answered just one more business-oriented questions from a capital point of view. Historically, we have looked at our ROEs over cycles, across down cycle or up cycle and it seems that we do kind of a lot of work for end clients in terms of taking the working capital investments on our books taking the R&D expenses so in effect, there is a lot of work that we do for our client but theROE that the business has been able to generate over a like 5-year, 10 year or 15 year period has been around 14% to 15% average net of tax. So is there an inherent nature of this business? Globally, it appears everybody else around in the business kind of ends up making this much.

Kedar Vaze: Just to answer that very clearly, if you look at the last 5 years, the results have been much poorer than normal times, so some de-growth on certain clients and the whole picture changes due to this thing. But on a longer term, if you kind of look at a 20-year average, we are more close to the 20% return on investment. We have gone through a phase of heavy investments and a couple of years of de-growth, where these ratios are both numerator and denominator have been affected. Now, we are looking to continue to grow and if you see the assets and fixed assets, we need to sweat them, we need to grow our business on the asset base that we have and the denominator being the same as the numerator increases, we will see these returns ratios coming back to healthy levels.

Ravi Purohit: So, what is the potential for us to kind of sweat these assets in terms of where can we take the asset turns to from where they are today?

Kedar Vaze: So, from entirely fixed assets roughly we have odd Rs. 700 crore of fixed assets in the network, which are currently enough for us to do even a double or triple the revenue that we have today.

Ravi Purohit: But this double to triple revenue, it will be difficult to enter the business as it is a very sticky business on the end-customer point of view.

Kedar Vaze: Actually, we are not saying that we can double our revenue in 1 year or 2 years. It will grow 10% to 15% for year on year but CAPEX outflow for next 6 to8 years of growth is already done.

Ravi Purohit: A second question is on the small acquisitions that we have been making to expand our end addressable markets. We have seen a host of other companies where the acquisitions end up being the drag on ROEs overall. Sometimes, they work.. sometimes, they do not work. It swells up the balance sheet but does not give you the expected return on a long run.

Kedar Vaze: Another point which is important to note is that while we are talking about consolidated ROE, we can also look at the ROE on the European business acquisition based on the fact that the risk-free return on Euro terms is almost close to zero. Even if we make 8% or 10% ROE in Euro terms and we are making a similar risk-free return adjusted a good return on those investments. Hence, the consolidated business basis also, the ROEs, in INR terms, they would be ballpark 20%, in Euro terms they are definitely very attractive because we also borrow and the kind of risk free return on Euro is almost at a zero level today.

Shrikant Mate: So, these are funded by low-cost debt.

Kedar Vaze: These are all basically funded by Euro-denominated debt at very low-cost numbers.

Moderator: The next question is from the line of Rohit Ohri from Progressive Shares.

Rohit Ohri: I have two questions which are related to the investments made in the Ayurvedic extracts business, which could be the next growth stage for evolution in terms of the value-added fragrances and flavors. So, would you like to share some thoughts on that as to what opportunities you are seeing and what would be the market size that is there in domestic or the international market?

Kedar Vaze: I would club together the Ayurvedic with the earlier discussion on Santalol. These are all the natural active ingredients or natural based products, which is a general trend which we see across the board. We call it the naturals and wellness platform. We are looking to enhance this. Currently, our business is around the Rs. 5-6 crore annual level, with the addition of Santalol, addition of basic research around some of the well-known actives in the Indian space, we will look to enhance this business more as a value addition for our current business offerings in fragrances. So, by itself, there are other extract manufacturers, who are already in the business and that market is may be estimated at odd Rs. 1,500 crore market. But our objective is to use this as value addition and making specialized extraction with science-based formulations, where we can enhance the value for our clients. So, by itself the Ayurvedic and the Santalol business may not be large, I would anticipate another Rs. 15 to 20 crore of business in the near future which we will get from these activities. It is a platform where our product development teams add a lot of unique value addition.

Rohit Ohri: So, the margins profile in this domain for Ayurvedic products or maybe immunity boosters these are at what levels?

Kedar Vaze: The same 50% gross margin levels.

Moderator: The next question is from the line of Arpan Shah, an Individual Investor.

Arpan Shah: I have a question, is it possible that we can grow in a high double-digits which are northwards of 15%-20%?

Kedar Vaze: There are business opportunities which are large, say Rs. 40 to 50 crore. If some of the opportunities materialize next year, we would see a year where we do 20%

growth. But these are things which typically last for 2 to 3 years, they are cyclical businesses and when you win the business, you get a big leg-up and in an event that you are not able to defend, you will lose a business. You will look at a leg down, where you will lose 2% to 3% of your business in one year. These incremental 5% over and above the 12% to 13% underlying growth can happen for 1 or 2 years and it has its own dynamics where the global branch has a core listing and has a certain time-frame lifecycle for its products. Our underlying 12% to 13% growth indication is on our current business, which is not cyclical. On top of it, we may get some additional business for a few years, which is more on a kind of cyclical product life cycle. So, the product can come in. We can add Rs. 50 crore business for 3 years after which the business will go to somebody else and then you may lose that business. This is in addition to the underlying growth of 12% that we have.

Arpan Shah: On a Rs. 700 crore CAPEX for next 3 to 5 years, we can grow at 10% to 12%?

Kedar Vaze: So, our CAPEX intensity will be quite low. I anticipate around the Rs. 25 crore mark for the CAPEX largely in Europe. Now with the new investment where there will be some additional CAPEX yes, plus some automation, improvement in laboratory equipments, things like this but from the plant and machinery and capacity point of view, we have adequately invested.

Arpan Shah: As per your debt plan, is it fair to assume that in next 1-1.5 year, we will be debt free?

Kedar Vaze: I am confident that we will be able to generate Rs. 300 crore of cash flow in these 2 to 3 years' period. I would just put a disclaimer on the current situation. Given COVID, there may be a few months of difficult growth but anywhere between 2 and 3 years, we anticipate a positive cash flow of odd Rs. 300 crore, which will enable us to reduce the debt. We will look at opportunities in case there are some things coming up, so I do not want to target that we will have a debt-free situation but to have the target that so much free cash flow will be generated in the next 2.5 years. If we do not find any investment opportunity, we will reduce the debt accordingly.

Moderator: The next question is from the line of Nikhil Jain from Galaxy International.

Nikhil Jain: I just wanted to understand, who is the biggest competitor in the Indian market and what could be the market share that we actually hold in India and in Italy?

Kedar Vaze: It would not be very fair to compare our competitor in India. We have now almost 45% of our business outside India as well. In the overview, we have 4 or 5 global F&F companies like Givaudan, IFF, Firmenich, Symrise, which are the global competitors. These are also our large competitors in the Indian market or pretty much in all of the markets where we are operating. I would look at these as our potential competitors in across the regions.

Nikhil Jain: Would it be fair to say that the top five players including yourself and other four competition would actually be controlling around 70% to 80% of the market or maybe a little more?

Kedar Vaze: In Indian market yes, outside situation in each market can be slightly different. But in general, top 4 to 5 players are controlling 70% to 80% market, in pretty much all the markets that we are operating.

Moderator: The next question is from the line of Apurv Mehta from AM Investments.

Apurv Mehta: Just wanted to understand that any synergy benefits can we accrue from CFF where we have common R&D, structure or common raw material sources and kind of things?

Kedar Vaze: Obviously, we have identified two of the main synergy areas, which are the product development, R&D, sharing of product prototypes, synergies on raw material all of those are obvious synergies, which we will play out and which we will take advantage of in the years to come. At this moment, given the pandemic, we are not really driving the synergy aspect of the business making sure that the business is running through the pandemic in the right manner. In a better environment, we will look to drive these synergies from further consolidation.

Apurv Mehta: Any cost saving of products to their customers or their products to Indian customers?

Kedar Vaze: The objective is to enhance the amount of offerings,both for Europe as well as for the Indian market. Like I alluded, the Ayurvedic extract and natural platform for Europe is a very strong platform, where India is a well-known source of many of these naturals. We are looking at value added products from the naturals to be sold in European markets. And likewise, there are certain categories where the European based raw materials can be used and we will use the synergies at the appropriate time. I would say that we have not yet built the synergy part of the equation for CFF and us and with Nova into our results because they are more or less running as standalone companies at the moment.

Apurv Mehta: Can you just quantify the new products which we have developed over last 2-3 years, what kind of contribution are we getting from the new developments and are these new developments always margin accretive?

Kedar Vaze: So typically, new developments are margin-accretive. At an aggregate level, definitely, they are margin accretive, maybe product by product, it can be slightly different. I think last 3 years, 12% of our business has been in new products and new business. It has been a fairly steady ratio between 10% and 15% of the business is between products which are developed in the last 3 to 4 years.

Apurv Mehta: How is the timeline to get a new customer? From pitching to a new customer and getting a new customer and selling the product?

Kedar Vaze: So, in different markets, there are different situations. We, in India, have quite a large market reach in the Fragrance business. Flavors, we are still adding a lot of new customers, Outside India and Europe, Southeast Asia, and Middle-East, we are adding new customers and new products, so it is different in different markets.

Apurv Mehta: Last question, how is the Flavours market, can we really grow at a faster pace in the Flavours market? Because the revenue is too small.

Kedar Vaze: Yes, I think the Flavour market, we are continuing to grow and we will see a faster rate of growth as a percentage of growth in the Flavours market than in the fragrance overall market. We anticipate basically excess of 15% to 17% CAGR growth in the flavor market.

Moderator: The next question is from the line of Shishir Agrawal from Top 100 Public Shareholder.

Shishir Agrawal: My question would be on BASF Isobionics, what would be the top-line expectation for FY23-FY24 and what margins are we looking at?

Kedar Vaze: The typical top-line we would be considering is something like Rs. 25 crore from this business and we are basically distributing the product, the margin in that would not be very high. I would anticipate a 10% margin but there is no additional cost, so maybe 1% or 2% marketing costs and 7%-8% would be the net margin for us on that product.

Shishir Agrawal: How much of this Santalol you would be able to incorporate in our current F&F products sales?

Kedar Vaze: Probably Rs. 5 crore odd will go in in-house consumption which we have not considered in above Rs. 25 crore. So maybe another Rs. 5 crore will be in-house, which will help us manage the gross margin to some extent to reduce our gross margin. But that impact is quite minimal.

Shishir Agrawal: What would be the term for the contract, you have a long-term arrangement for 3 years, 5 years or 10 years and would in future, the SHK Group fully enters into joint venture with BASF or manufactures the same in India?

Kedar Vaze: So, it is possible to look at various options in the future. I mean we do not rule out anything. We have been working very closely for collaboration with the company - Isobionics - from the beginning. We have been doing contract manufacturing for them for some other products and we will look forward to some additional long-term association of manufacturing. It is early days for the product. I do not want to comment anything for longer term but it will make sense to have some kind of domestic manufacturing for this product in the future.

Shishir Agrawal: My last question would be what are the new molecule or new product launches we are looking at in current year?

Kedar Vaze: Typically, we do roughly 500 odd Fragrance & Flavours launches in a year, so these are our new product launches. In terms of new molecules, we are not launching new molecules to the market. They are mainly for our in-house use and we continue to develop and use them internally.

Moderator: Ladies and gentlemen, that will be the last question for today. I now hand the conference to the management for closing comments.

Kedar Vaze: I hope we have been able to answer all your questions satisfactorily. Should you need any further clarification or 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 very much, ladies and gentlemen, on behalf of S H Kelkar & Company. That concludes today's call. Thank you all for joining us and you may now disconnect your lines.

-End-

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