February 20, 2020

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 Q3 FY 20 earnings conference call for investors and analysts organized by the Company on Monday, February 10, 2020 at 11:00 AM IST.

You are requested to take the same on record.

Thanking you,

Yours faithfully,

For **S H Kelkar and Company Limited**

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Deepti Chandratre
Company Secretary & Compliance Officer

Encl: As Above

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SH Kelkar and Co. Limited

Q3 and 9M FY20 Earnings Conference Call
February 10, 2020

Moderator: Ladies and gentlemen, good morning and welcome to SH Kelkar and Co. Limited 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 the 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 morning, everyone. And thank you for joining us on SH Kelkar and Company Limited's Q3 and 9M FY20 Earnings Conference Call. We have with us Mr. Kedar Vaze – Whole-time Director and CEO; Mr. B. Ramkrishnan – Head Strategy and Mr. Shrikant Mate – VP and Group CFO of the Company. We will begin with opening remarks from the management following which we 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, maybe forward looking in nature. And a disclaimer to this effect has been included in the Earnings Presentation shared with you earlier. I will now invite Kedar to make his opening remarks.

Kedar Vaze: Good morning and thank you for joining us on the SH Kelkar and Company Q3 and 9M FY20 Earnings Conference Call. I will initiate by taking you through the key highlights of the period under review. We will then look forward to taking your questions and suggestions.

I am happy to share that we have reported a healthy uptick in performance during the quarter and nine months ended December 31, 2019. The performance was led by steady improvement in demand across all our core business categories, increased client engagements and broad based normalization in the domestic market.

On a consolidated basis, our revenues from operations stood at Rs. 835 crore for 9M FY20 as against Rs. 773 crore in 9M FY19, a growth of 8% year-on-year. In Q3 FY20, revenues came at Rs. 288 crore higher by 13% year-on-year. We saw an increase in client engagement with existing and new FMCG customers during the quarter, which helped our overall performance.

On the profitability front, EBITDA for the nine months ended December 31, 2019 increased by 6% to Rs. 132 crore and EBITDA margin stood at 15.5%. In Q3 FY20, EBITDA stood at Rs. 45 crore with margins at 15.5%. The raw material environment in the domestic and global markets has now broadly stabilized. A steady operating environment along with several cost optimization measures that are being undertaken should continue to help us augment EBITDA margins, going forward.

Interest cost during the nine month period increased to Rs. 21 crore and depreciation stood higher at Rs. 39 crore. The increase was primarily on account of commissioning of the new facility at Mahad and the adoption of the new accounting standards.

I would also like to share here that the company initiated the final closure of our fragrance ingredient facility and research activity in the Netherlands during this quarter. This follows the shift of operations from Netherlands to a high quality and operationally efficient centre like India. The impairment of plant and machinery and other closure cost resulted in a one-time exceptional expense of Rs. 36.5 crore which is net of expected realizable value. So, this impacted our reported profit during the Q3 and 9M period. However, a substantial part of this expense is non-cash impairment charge. Furthermore, the economic value of the investment has already been fully recouped and it has been integrated with our operations in the group. We are now actively exploring options to maximize the monetization of the plant infrastructure including by way of a slump sale or through a new venture in collaboration with potential investors or business partners.

With global demand for Tonalid rising, I am pleased to share that the replacement facility at Mahad has recorded an all-time high production during this quarter. This facility is now operating at full utilization levels and in the longer term, it will help improve availability of key raw materials given the flexibility we would have in our operations.

Adjusted for a one-time exceptional expense, PAT during the quarter stood at Rs. 25.2 crore higher by 18%. In 9M FY20, PAT excluding one-time exceptional cost stood at 59.2 crore as against 67.7 crore in 9M FY19.

Moving on to our segmental performance:

The fragrance division delivered a 14% revenue growth in Q3 FY20. The domestic business reported a robust growth of 22%. In 9M FY20, domestic fragrance business reported a growth of 8% and overseas revenue grew by 13%. Operating profit during Q3 stood at Rs. 32 crore as against Rs. 37 crore in Q3 FY19. In 9M FY20, operating profits stood at Rs. 94 crore as against Rs. 103 crore in the similar period last year.

In our flavors division:

The top line performance was stable both - in domestic and international segments - during Q3 FY20. During 9M FY20, domestic revenues came in lower by 20% led by subdued demand witnessed in the first half. Our overseas segment reported an improvement of 11% year-on-year. In Q3 FY20, the segment reported an operating profit of Rs. 4 crore, with margin at 16%. In 9M FY20, the operating profits stood at Rs. 11 crore.

Coming to a key development during the quarter:

I am happy to share that the stabilizing markets and improving liquidity conditions have resulted in a normalized working capital, better collections and improved cash flow. Cash from operations stood strong at Rs. 121 crore during the quarter owing to overall improvement in the total working capital cycle. This has enabled the Company to reduce its net debt as on December 31, 2019 to Rs. 303 crore as compared to Rs. 400 crore as on September 30, 2019.

On a quarter-on-quarter basis, net debt has reduced by Rs. 97 crore and our net debt to equity position has improved to 0.37x as on December 2019. We anticipate this trend to continue in Q4 FY20, which will further strengthen our balance sheet and cash flows, going forward and we are well on target to generate our promised Rs. 140 crore to 150 crore free cash for the full year.

As we look ahead, we continue to see an immense potential across all our business segments over the longer term. With macros stabilizing, we see further healthy traction in terms of order enquiries and leads, especially from our large FMCG customer segments. We believe this, along with new products and brand launches in the FMCG sector and the implementation of our strategic growth measures, should enable us to report a healthy and sustained performance in the domestic as well as international markets.

With this, I would now request the moderator to open the forum for any questions or suggestions that you may have.

Moderator: Thank you. Ladies and gentlemen, we will now begin with the question and answer session. The first question is from the line of Nagaraj Chandrashekhar from Laburnum Capital. Please go ahead.

N Chandrashekhar: Just a question on the competitive dynamics in the sector. So if I were to take a medium term view, it looks like there are more MNCs competing more aggressively in our space in India than there were maybe 5 or 10 years ago. And overall, one or two of them have gained share and several Indian companies have lost a little bit of share. I am curious to get your take on this, is this because the MNCs are taking incremental share in the clients we have or is it the case that their clients or the products they are levered to are taking share from our products. So what has actually caused the shift in market share? And second question is, with this substantially enhanced competition and with all of these companies really viewing India as a very important long term strategic market for them, what is our right to win in this space, we're up against people who have deep institutional relations with the MNCs at a global level, they have a very strong research and chemistry capabilities. So, how do we position ourselves to be able to compete against these giants with really strong technology and perfuming capabilities?

Kedar Vaze: So, answering that in a broader light, in the last two years, as a result of the demonetization and GST, there have been a lot of structural changes in the marketplace and number of smaller FMCG brands found it difficult to adapt to the new environment in the similar manner as the bigger organized companies do. So within our portfolio and most Indian fragrance and flavors company portfolio, the larger customers continue to grow and the smaller customers face challenges. Now, as a result of this, the overall market share of the large customers, where global fragrance MNCs have a larger share in the larger customers, so they continued to grow vis-à-vis their Indian counterparts including us in the domestic market. To answer your question as to what do we see as our unique strengths and positioning vis-à-vis the large global companies, I think we have almost 100 year track record. We have been competing with them since they opened their subsidiaries in the Indian market and in the Asian markets since the early 1990s. And for the last 30 years, we have been competing with them across all the accounts that we continue to service. And the proof of the pudding is in the eating. So we are definitely doing some things right. We continue to innovate. We continue to have the like-for-like R&D spends. We may not have the same value of spends but we are very focused to what our clients need. And with that we are able to make the R&D and development spends matter most in the critical winning areas. With that, the track record itself is the best judgment of why we are able to compete and possibly continue to compete. Over the last 10 years, we have continued to invest on a global patenting regime, so we have more than 15 patents being filed across the world, including the developed markets such as US, EU and China, Brazil, Indonesia and India as the major economies of the world. And we have a strong research pipeline, we have a strong R&D support. We are continuously innovating in terms of products and our understanding of consumers is at granular level, which allows us to compete in a much more focused manner with our clients. And that has been our success and we will continue to replicate the same going forward.

N Chandrashekhar: Just a follow up, if I take the top five, sort of MNC or just generally the top five FMCG players in India. How many of them would you have gained share in, in the last 5 or 10 years. And how many of them would you have lost share in?

Kedar Vaze: I think from the top five it is a very small number. If you take the top 20 FMCG companies in India, we would have gained share in many of top 20 companiesas a group in the last five years.

N Chandrashekhar: Okay, you would actually have gained share?

Kedar Vaze: We have valued this overall numbers in our call in the past 2 or 4 quarters ago, where we talked about how the market has changed from the big companies - the five segments in the domestic business - ABCDE. E being the consumer and how the business has migrated from D and C to B and A respectively and that has resulted in a one-off de-growth for the smaller clients. We have now seen stabilization and expect continued growth for us in the coming market.

Moderator: Thank you. The next question is from the line of Chirag Dagli from HDFC AMC. Please go ahead.

Chirag Dagli: What is the 9MFY20 R&D spend?

Kedar Vaze: Roughly 3% of the revenue.

Chirag Dagli: This was large in FY19?

Kedar Vaze: So, last two years, the R&D spends have been at 3% to 4% of our revenues.

Chirag Dagli: Would you like to share some outlook on FY21, how does it look now that operations have broadly normalized, your capacities are also now fairly well utilized?

Kedar Vaze: From a longer term view, we had a mis-match of the Netherlands operations in terms of cost and the market. As they were selling products to the global market and we were producing in the European context. We have now moved that to India and the plant in China. So, the mis-match between the revenues and the cost structure in a structural form has been corrected. Now all our revenues and operations are focused on the market and the operations in those markets. So, we do not have any negative cost structure on a structural basis so that allows us to be more flexible, more agile to the market realities both in growth and in challenges that we face. In 2021, we foresee that we will continue our double digit plus growth and improving margins. We have already indicated that we will touch 18% EBITDA margins and we are very well poised to fit those numbers. In terms of the business challenges, we are now geared, we have the product mix, we have very strong pipeline of products and projects that are coming on stream. So, we see 2021 as a year where the business will normalize post the twin effects of GST and demonetization and we should have a healthy growth and profitability.

Chirag Dagli: This 18% is for FY21 or is this longer term?

Kedar Vaze: So, FY21, we have indicated 18% and above, I think in longer term, we would like to see the EBITDA margins around the 20% range.

Chirag Dagli: Okay sir, perfect. And the Netherland's piece… is there a salvage value to this, you've taken some hit in the P&L but do you think you will get anything when you sell the land?

Kedar Vaze: Out of the total impairment, there is a Rs. 10 crore impairment cost and closure cost in terms of outlay and there is a Rs. 26 crore of impairment as an accounting entry. Now we are in talks, in various stages to utilize this equipment for other operations within Europe. So there will only be Rs. 10 crore actual cash hit, remaining is an accounting hit on account of unutilized plant and we are hopeful to utilize the plant as a consequence of doing other activities in the future.

Chirag Dagli: It is likely that you reuse this equipment rather than sell it upfront?

Kedar Vaze: That's right. Actual plant and machinery has already been written off and we have bought it out to the Indian facility. So, whatever we can salvage and use we will use in the Indian facility. The remaining value now is mainly land and buildings, and we will take that and utilize it as the case may be in the future.

Chirag Dagli: Okay, this is likely to be a joint venture kind of a thing for new products or something like that?

Kedar Vaze: That's the idea. So, like I alluded earlier, the Netherlands facility was making products which were sold in the global market. We have now moved that operations to India and China. So, all the products that are sold in the global markets are produced in either our Chinese plant or the Indian plants. And the Netherlands plant as a result will be vacated and we will use it for specific tailor-made products for the European market. This could be our own market; this could be a spillover from our Italian acquisition or additional joint ventures with third parties. So the options we are exploring.

Chirag Dagli: Okay, lastly, on the virus in China, how does this impact our business?

Kedar Vaze: Firstly, let me put out our prayers to everybody, who is affected by this in a manner of showing our solidarity to the Chinese people and the people who are dealing with this currently. We are constantly in touch with our suppliers and with the various authorities in China. As of now, we do not foresee any disturbance for our operations in Q4, right up till the end of April. We are closely monitoring the situation and should have a detailed update at the end of February. But as of now, we are covered with all our raw materials and all the necessary plan B's to continue production in zero disturbance manner till the end of April. As a result of the New Year, we had already planned maintenance shutdown in our plant in China. So that was planned to be closed. We have continued to extend the closure as a part of these steps taken by the government. But we had already increased our stock level and production capacity in Mahad to take over the additional demands. We don't foresee any reduction in production or any adverse effects till end of April.

Moderator: Thank you. The next question is from the line of Alpesh Thacker from Motilal Oswal Financial Services. Please go ahead.

Alpesh Thacker: There was an employee restructuring cost that had happened in Q2 and which was expected to be there in Q3 also. So, were there any such restructuring costs this time?

Kedar Vaze: Yes, there are some parts of the restructuring cost which are a result of the plant closure. We will have additional restructuring costs on account of completion or termination or severance in Q4 which I estimate to be between Rs. 4 – Rs. 5 crore for the year and that would be the last one off restructuring that we will be undertaking.

Alpesh Thacker: Okay. So, this would be related to the employee cost right. That we had taken up in Q2 also?

Kedar Vaze: Yes, we had taken some of it in Q2, some of that has come in Q3 as a part of the Netherlands closure. Some of it will continue to spill over to Q4 also. As we restructure the businesses into specific business units, we are mindful that we do this in a manner that is proper and to ensure there is minimum disturbance to the business and the people that are working with the organization.

Alpesh Thacker: Okay. What is the status of the CFF consolidation?

Kedar Vaze: We are originally looking to consolidate the company by the end of the quarter and calendar year 2019. Within the group, the Board has decided to defer the acquisition of 49% beyond 2019 - the time frame disclosed earlier. We will now go back to the arrangement as discussed in the original agreement that we had between two to three years to acquire. And we will communicate with the sellers and agree on a timeline on the next steps. Our best estimate is that sometime in the next year first quarter, we should be able to close the CFF transaction for the balance 49%, on terms which we will agree with the seller.

Alpesh Thacker: Okay. Lastly, what would be the capacity utilization from the Mahad facility and the overall blended capacity utilization for our plants?

Kedar Vaze: So the Mahad facility today is at almost 80% plant utilization. For the balance facilities, we are around 50% combined utilization.

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

Naitik Mody: For the FY21 outlook, could you please comment on the more granular growth for both segments of fragrance and flavors as well as some sense on the domestic as well as export growth?

Kedar Vaze: If I look at dividing 2021, this is the general expected growth rate, our growth rates on the flavours will be 17%-18% type of growth rate - both domestic and export. In the Domestic fragrance, on a larger base, we expect to do double digit plus with a ballpark of 12% year-on-year growth and in the International fragrance, we are doing 15% year-on-year growth for this year and we will expect to continue the same level of growth for the coming year.

Naitik Mody: How is the overall market in India for both these segments?

Kedar Vaze: On both the segments, the growth has slowed versus the previous years. We are guesstimating, we don't have any specific detailed survey. But we are guesstimating that the fragrance growth is 6% to 7% for the year as an industry and we would have 8% to 9% as growth for the flavor industry.

Moderator: Thank you. The next question is from the line of Sandip Sabharwal from Ask Sandip Sabharwal. Please go ahead.

Sandip Sabharwal: Can you give me some estimate on what is the capital expenditure you are looking at for next year?

Kedar Vaze: We will conclude the CFF acquisition, which will be a capital expenditure to the tune of €16 to €18 million. Apart from that, our normal capital expenditure on organic basis would be around Rs. 16 crore odd levels.

Sandip Sabharwal: So you have actually grown through acquisition in the past also, but over the last two, three years given the kind of increase in debt, it's led to a de-rating of the stock. So it used to trade at very high valuations when the debt levels were very low, but increasing debt has hurt the shareholders of the companies. So, how are you looking at this scenario going forward?

Kedar Vaze: As I mentioned earlier, we've already brought down the debt by Rs 100 crore in this quarter and we if continue to operate on a normal basis, the debt will quickly come down. The main scenario has been kind of a double whammy, particularly last couple of years where there was force majeure on raw material and there was low growth in the marketplace. So we're now seeing signs that it is correcting and we have put our business practices and business model in-line with the current expected business growth. So, I think we will come back to the free cash flow scenario and debt levels as it was in the past.

Sandip Sabharwal: Looking at what happened that took you by surprise, both in terms of raw materials slowdown in market and increase in debt levels, so would you be more cautious looking at acquisitions in the future?

Kedar Vaze: Not really, if you look at the scenario of the acquisitions, we did couple of investments - one was in the Mahad plant, where we actually benefited from the disturbances as in the global supply chain by having better realizations as the plant came on stream vis-à-vis the other acquisitions and CFF acquisition, which we had done two years ago, before the GST and demonetization. We had no additional data or additional way of knowing that this would happen in the future. So, I think we have been conservative. Our debt equity ratio, even in the worst situation is less than 1. So we are very conservative as far as taking on debt for any kind of expansion. But I don't believe that the decisions we have taken are incorrect. It is just that the subsequent events have substantially changed the way of business and the environment of the business. So, we had no way of anticipating those at the time the decision was taken. So, if you ask me today whether I would have done something differently, I wouldn't have been able to do something differently. We had no other data points, but we will evaluate and make sure that we have additional risk parameters or kind of wider 'what ifs' in terms of our assumptions going forward as a learning. But the kinds of changes that have happened in the industry are not something which any plan would have taken into account.

Sandip Sabharwal: Okay lastly, you saw a substantial decline in net debt levels, but this reduction is quite exceptional. So what kind of pace of debt reduction do you see could happen going forward?

Kedar Vaze: This reduction, as you mentioned, is exceptional. We would not see the same pace of reduction going forward as we are brought down to more normal levels of working capital. Going forward, I think we will have 65% of our profit coming out as free cash flow and I would anticipate Rs. 20 to Rs. 25 crore of debt reduction per quarter.

Moderator: Thank you. The next question is from the line of Rohit Nagraj from Sunidhi Securities. Please go ahead.

Rohit Nagraj: Could you give us some color on the key ingredients availability and prices like turpentine, etc?

Kedar Vaze: So, the scenario there is, we have proper availability as of end of October, November. We have products in contract for our requirements. I will reserve my judgment in terms of making sure, what are the effects of the coronavirus on the supply chain particularly as we mentioned for pinene**.** But by and large, we have stock in hand and we hope and pray that things will normalize and we will have a normal situation after April. As of now, there will be no hit to the immediate raw material price or cost for us and we will take a relook at it in February.

Rohit Nagraj: So we have not seen any price changes over the last, maybe, couple of weeks or 20 days after this disruption in China due to the virus?

Kedar Vaze: We have seen a huge price spike in the markets for lot of raw materials under the disturbance but these are more of panic-buying and because the production operations is key, if they restore before end of February to normal levels, I don't anticipate there will be any major change in raw material pricing thereafter. If they don't restore the plants, normal production in China and supply by end of February, then we will put out exact view of what happens and if there is any change in the business. I hope and pray that things are normalized and the people of China should be able to overcome this national and global crisis and we will take all steps required to enable that our suppliers are able to restore their production quickly. And at this point, there is no disturbance for us till April. As I alluded, we have covered all the raw materials, they are all in our godowns or in the ports. But we will relook this at the end of February and put out any notice if there is any significant change.

Rohit Nagraj: In an unfortunate situation, wherein the production does not come to normal, do we have the ability to pass on the prices to our customers this being a force majeure and will customers understand it?

Kedar Vaze: Yes, I think, we are also in communication with our customers. They all understand the gravity and the scenario of the situation. So we will work together with our customers and alternate suppliers, alternate products to ensure minimum disturbance to the business. Again, I want to reiterate that we are well covered with all the stocks and we don't see any disturbance till end of April.

Rohit Nagraj: That's good to hear sir. Another question on the strategy front, so you said that domestic fragrance market growth rate is about 7%. But we are outperforming in both domestic as well as global growth rate. So here are we gaining share from the MNC players or all the smaller unorganized players who are basically going out of the system. How are we taking this market share from the players?

Kedar Vaze: It's a combination of both. We are continuing to win our share of new products that are put out in the market. The brand and the products that we have in the current market are growing faster than the average of the market. So, as a result of that, our market share and our growth is faster than the overall market average.

Rohit Nagraj: So what could be the revenues from new product introductions from last five years and is there any change in terms of the product lifecycle. So, earlier product lifecycle was say 10 years and now it has reduced to 5 years because of the customer preferences and choice of new flavours or fragrances?

Kedar Vaze: There is no change in the lifecycle of products. We continue to have long lifecycle products and our customers are working with establishing long term brands in the market. That's the market which we operate in. There are few products that do have lifecycle of two to three years, we have very limited businesses in three year lifecycle products. In terms of the new products, over a five years data, I don't have that readily available. But, we normally evaluate last three years as our new product business and we have roughly 12% to 13% of revenues from this business.

Moderator: Thank you. The next question is from the line of Vicky Punjabi from JM Financial. Please go ahead.

Vicky Punjabi: On the international fragrances side, we seem to have seen some kind of a slowdown this quarter. Is this mere phasing or are there certain issues cropping up there?

Kedar Vaze: I think that's a seasonal quarterly scenario. If you look at the international segment, we have 13% growth in the nine months. Last quarter to this quarter, there is a no real momentum change it's a small difference in terms of the shipment going out on specific times.

Vicky Punjabi: Okay. Just on the domestic fragrance side, this quarter, the growth has been strong but there was a weak base as well and I think possibly that continues for the next quarter. But beyond that, what is the kind of growth rate that you are looking at?

Kedar Vaze: I think we will continue to do 12% growth rate for domestic fragrance that is our expected target for FY21. And we have seen good level of pipeline of new wins and good momentum across the entire segment in terms of growth of our current business.

Vicky Punjabi: Just on that, because the end consumer markets are seeing a sharp slow-down right now. So, where is this, I just wanted to understand what's the background of this 10%, 12%. How do you get that confidence given the current market scenario?

Kedar Vaze: As you see, even during our worst years, last year and the year before, we have grown underlying business to business at 12% plus and even 15% growth and we have de-grown on certain segments and certain products. So, at this moment, we have this churn of product mix and the customer mix has already happened. The larger customers have seen even 15% to 18%, also 20% growth. So, I think the momentum for the 12% is already embedded in the business, in the brands and the products that we are working with. I also see that as a result of force majeure and the corresponding changes in the business environment, there is an automatic consolidation from smaller players to larger players in the Indian context as well. That helps us as number of customers are looking for reliable suppliers.

Vicky Punjabi: Taking the same thought on flavor segment which is even more fragmented. But out there such a change has not really happened. I mean, the trajectory in flavours revenues has been very tepid. Can you help us understand what's happening there exactly and how are we looking to revive that?

Kedar Vaze: So, in the flavours segment, we have alluded last time, we had a one off problem with the citrus, this quarter and the next quarter is the first quarter where there is no sequential base effect of these one-off transaction or one-off decline in business on account of the orange oil. If you see, sequential quarter-on-quarter and the underlying momentum in the business, we are very confident that we have good quality of new wins. We are working with the top MNC companies and domestic companies in the food FMCG. So our quality of product wins, quality of customer profile has improved dramatically in the last one year. If you read through the capitalization, we have set up our new facilities in R&D and sales and marketing in the last year. This year, we have almost received between 15 and 18 large FMCG customers across the country. We have had one innovation day with their R&D teams. Number of product concepts, which we started at the beginning of the year has been finalized and they are at various stages of launch. We have been also expanding our sales team, in particularly Africa and Southeast Asia. So all of these initiatives are starting to show fruit. And we are confident that our growth rate going forward will be excess of 15%.

Vicky Punjabi: We've read that the raw material scenario is now more benign. But on the gross margin side it is not really showing up, we are seeing Y-o-Y contraction and we are seeing sequential contraction as well. And on that Mahad plant, I thought that Mahad plant would come on stream and kind of with that fragrance ingredients facility now in-house you will see some margin benefits from there. But that also doesn't seem to be reflecting. Can you help us understand what things are in play out here?

Kedar Vaze: We end up with starting opening stocks and we end up with a closing stock and the closing stock which is in the finished goods also get valued with the new raw material in. So, as we are seeing the decline, we are seeing some part of that also going to the closing stocks, so there is an effect that the closing stock also gets valued correspondingly at a slightly lower level than what was the opening stock for like-for-like. So, as these prices continue to decline, we are seeing some of the gross margin is getting into the closing stock. This quarter we will see a stabilization of the prices on the basis of the new prices and we will see the actual improvement in the gross margin in this quarter.

Vicky Punjabi: You mean to say that at the consumption level, the lower cost raw materials will come in, in the fourth quarter?

Kedar Vaze: So, that has already started to come in only at the end of the quarter since the consumption is at a lower side, our finish good inventory is also valued at a lower cost, so this quarter, you will not see the big effect on gross margin. When we start to sell these inventories, we will start to see the gross margin impact. As a result of our stock carrying, we have roughly three months lag between what happens in the market and what happens in the P&L. So, as things improved in September, October, this quarter would be stable, next quarter we will start to see the results of that.

Vicky Punjabi: On the Mahad facility benefit?

Kedar Vaze: There has already been a substantial improvement in our gross margin in the first half owing to the Mahad facility. In the last quarter, we have seen some annual contracts being in pressure on pricing on the ingredients as a result of the global normalization. So we have seen corresponding pressure. But I think now that the facility is fully operating, we should be able to generate the sales and the margins. In a totality, our 43% gross margin will be compositionally different, there will be better margins on the formulations and slightly lower margins on the ingredient side. This will play out and I think, if we kind of stabilize that post Q1 FY21, the 43% may even touch a slightly better result. And we hope to bring it back to the 45% levels in long term.

Vicky Punjabi: Just a clarification here the gross margin will be 43%, better margin on formulation and lower on the ingredients, but the mix would be 43% right?

Kedar Vaze: Yes.

Vicky Punjabi: On that working capital release, I mean, it's a sharp release. This has come off, because aided by a lower material cost, or are we seeing some inventory deductions or something on that line?

Kedar Vaze: It's a combination of deduction in inventory, reduction in price, reduction in finished goods, turnaround time improvements, improvement in collections, which for me is a leading indicator of business momentum. So it's a combination of all the various factors. So, if you look at mid-year last year, we had higher inventories expecting the growth, the growth which did not happen. We were carrying through the inventories to kind of the next quarter and particularly the second quarter after the elections results we were hopeful that there will be a big momentum jump in the activity in the FMCG and consumer space. But, which we did not see but we had piled up inventory and readiness for that. So all of those we have brought down to more normal scenario. If you again go back last year, we saw very big second quarter in terms of demand and this year we did not see a very big second quarter. So we've taken steps accordingly and the stocks have been normalized in that scenario.

Moderator: Thank you. The next question is from the line of Anubhav Sahu from MC Research. Please go ahead.

Anubhav Sahu: On the raw material front, you mentioned sourcing wise we are covered till April. So does it also cover on the cost front?

Kedar Vaze: Yes, so we will not have any specific additional cost till April.

Anubhav Sahu: Okay. At present, we have around three months of inventory. So have we gone for a pre-buying because of the situation. Or is it a new normal for inventory management, given the raw material issues which we had in the past?

Kedar Vaze: If you go back in history, we had levels of six months plus stock in our business model. So we have normalized it to more to kind of three to four months of inventory, which we believe is a more normal level of working capital going forward.

Anubhav Sahu: On raw material front, if you can mention on how much do we import and what is the current China exposure we have on that front?

Kedar Vaze: Roughly 20% of our raw material is imported from China directly, there may be another 10% which is impacted from raw materials from China, we don't buy directly so, 30% of our overall basket will be affected by China in terms of supply. Again, on a longer term, if the supply does not restore, there will be another kind of pricing scenario or availability scenario. But as of now, we are covered well, without any reason to believe that we will have any supply issues.

Anubhav Sahu: Just to understand the situation better, the plants from which we source raw materials from China, what is the latest update you are getting? And if you can also provide an update on logistics front, because we are getting news that the plants may start manufacturing, but the logistic is a concern right now?

Kedar Vaze: So, by general discussion with all the plants and we are working with maybe 100 different manufacturers for different products, by and large they, are all closeed as on end of February. They have been indicated that the manufacturing will begin in a phased manner after that and they have indicated to us that the shipment dates will be post end of March or March 20, 2020 onwards and that they will be in a position to ship material then. All of these are initial indications. We are constantly in touch with vendors and their representatives for an update. I think on getting more meaningful update towards the end of February, we will have a clear picture and as I mentioned, we have the stock in play, at least already shipped from China due to be received or in our stock till end of April. So thereafter, we will be able to evaluate end of February.

Anubhav Sahu: Got it. Also due to this China situation are you getting any new inquiries from the export market. Do we have any new opportunities in the export market?

Kedar Vaze: Yes, it's a good question. We have a lot of inquiries coming up as a result of the China on an alternate suppliers basis. We are also observing and not wanting to take one-off kind of business which disturbs our production. So we will evaluate opportunities as they come but structurally, on a longer term, I think the India supply chain has higher rating in the global market now, which was largely depending on China sourcing. So, the allocation to Indian manufacturers is coming up from all our customers.

Moderator: Thank you. The next question is from the line of Ashok Shah from LLC Securities. Please go ahead.

Ashok Shah: Sir, we had earlier bought back our shares and not repaid debt and again, there was lots of restructuring going on. And provision is being made. Is it not the right time, as the Company is going through some pressure, Promoters should also reduce their salary remuneration at least for the one year to bring back the Company on a strong footing.

Kedar Vaze: I will not answer this as I am partly in conflict with the question itself. I will direct the question to the Nomination & Remuneration Committee (NRC) and again put out a public note to the answer.

Moderator: Thank you. The next question is from the line of Chirag Dagli from HDFC AMC. Please go ahead.

Chirag Dagli: Sir, new segments like air fresheners, paints, etc are a big focus area. How are they doing if you have any updates to share in terms of big account wins, etc?

Kedar Vaze: So the segments are tracking well. We have good revenue from industrial segments. And these are new areas of business which are not traditional FMCG and already it is up by 65% from last year and we hope to end maybe in excess of Rs. 10 crore plus in this business. And these introductions have been well received in the market, particularly during the festival season and we will see that in the years to come, this will be a sustainable growth platform. This is a very large untapped market. So, we will plan that and grow this market.

Chirag Dagli: Who competes with you sir in this market?

Kedar Vaze: There are not many competitors. So, this is a new segment we are addressing.

Chirag Dagli: Okay, none of the MNCs are present in this?

Kedar Vaze: To the best of my knowledge, I think, no. There might be one or two MNCs who have this in terms of global but not on all the segments. But by and large, we are fairly unique in our offering.

Chirag Dagli: Okay, sir. And can you share broad guidance of where this business can be three, four, five years out?

Kedar Vaze: So, let me say that the Rs. 10 crore represents only 3% to 4% of the immediate potentials. So, in terms of potential business, it is excess of Rs. 200 crore segment. It will not reach there overnight so, it will take time for the penetration of these products in the market. But we see that this segment itself could be a Rs. 200 crore vertical for us.

Chirag Dagli: Okay, sir that is helpful. And the delay in CFF.. is this because you're trying to integrate this with what you will do with the Netherlands, land and equipment?

Kedar Vaze: No, the delay was on account of certain conditions that we wanted to ensure. It was also a difficult scenario in terms of the force majeure and raw material availability that we decided not to integrate CFF this year, till there were more normalcies on the business. Now that there is a good visibility on the raw material and normalcy is more close at hand, we decided that we should go and acquire the balance 49%.

Chirag Dagli: So, this will happen in FY21 second half?

Kedar Vaze: This should happen in FY21 first half.

Chirag Dagli: Is there a guidance you want to share with us on this business, what should we expect?

Kedar Vaze: I think we will put out a full proforma on the CFF business by end of February once the transaction details are concluded with the seller. Then we will put out the business, the necessary numbers for 2019 and expectations and the strategic rationale as a separate note.

Chirag Dagli: Is there a tax rate guidance that you want to share with us?

Kedar Vaze: All over units are more or less at the 25% new tax rate plus surcharges, if any. So, we are all at the same tax credit.

Chirag Dagli: What is the nature of the other incomes, and is this base sustainable?

Kedar Vaze: Nature of this is some scrap sale and things like this, so this is not really other income from any other source, it is just the normal foreign exchange changes or scrap sales.

Chirag Dagli: So this Rs. 5 to Rs. 6 crore annually is a sustainable number?

Kedar Vaze: It is, I would put a caveat that it is expectation based on how foreign exchange is normally moving. There would be a year or quarter where it may reverse. So, this is mark to market basis income.

Moderator: Thank you. The next question is from the line of the Nagaraj Chandrashekhar from Laburnum Capital. Please go ahead.

N Chandrashekhar: Just a follow up question in terms of us versus the competition, could you give us, when we look at incremental business that we're winning with clients. Who are the competitors, we typically see and what kinds of products or what kinds of business are we particularly competitive and where we see us beating up the competition and where are we relatively weak in terms of competition beating us out?

Kedar Vaze: It's a very good question. I think we are in the kind of FMCG space normally there are three to four people who bid for business. As you said, on average in some cases it may be 2, in some cases it may be 7, 8, or 10. But on an average, three to four people compete on a business, we win on an average 15% to 18% of the projects that come our way, which is one in five more or less. So we are running by and large, at the same average as what is the industry best average. To answer your question more specifically on specific segments where we have strengths or weaknesses, the answer to that is very clearly, we have strong knowledge of the consumers in the markets that we are operating. There are specific products which have already been in the market in let's say US market or European market and they have been sold out into the Asian market and we have limited exposure or limited library on these products. So, we tend to take more time but at the end of the day, we are competitive across the board in these markets. Our big strength comes from our understanding of the consumer preferences and our in-depth understanding of the Asian and Indian and African markets, where we operate. So we're really agnostic to the technology of the category we can compete and we are competing and winning across all segments.

N Chandrashekhar: Sir you say that in general, you are most competitive, where the fragrance involved has some kind of a local aspect to it, say some kind of Indian traditional cultural aspect to it, because you have a good library there and you can create something that is well suited to that. Whereas, if people are looking to create a fragrance that has a more international global sense to it, they may be better off working with some of the MNCs, is that fair?

Kedar Vaze: No, that is wrong. We can compete and make international fragrances. It's basically we understand the Indian and the Asian consumers, that is our strength. So whatever you need in this market, we can give you and tailor-make it for the market better than global. And if you want me to make a fragrance for the United States of America consumer, obviously we don't have a starting point, we have not done too much work in those markets. Our understanding and our strength comes from our market understanding and not from product R&D.

N Chandrashekhar: But even within India, you're winning about 20% of the things you've been on, somebody else is winning 80% of them. So, even within India if you look, where are you most competitive within India and where are you losing within India.. that's what I am trying to understand?

Kedar Vaze: So there are 300 fragrance companies within India. If we are running and winning 20% of the market and in an average brief, there are three or four people competing, it means that we are winning 50% more than the average.

N Chandrashekhar: But within India, is there a pattern where you see that.. look for this kind of business, we're really competitive it's very unlikely anyone will beat us whereas for this other kind of business within India, we tend to lose a bit more, that's what I'm trying to understand?

Kedar Vaze: I think answer to this question has a lot of parameter, if it was black and white like this, it would be very easy for me to answer and it is not black and white. It depends on the customer, customer relationship, price point, end customer, end margin, credit rating of the customer, sometimes we don't want to do a business because it competes with some other customers or clients' business. So, there is a lot of play. Let me just say that in every category we are operating, we are in the top two or three companies in the market in terms of ability to win.

Moderator: Thank you. The next question is from the line of Suresh Jain, an Individual Shareholder. Please go ahead.

Suresh Jain: Small clarification required regarding CFF acquisition. After the Q1 result, it was announced that the acquisition was complete by acquiring the remaining 49% but now you're coming up and saying that it has been differed. So there is some confusion, now it was not done after Q1 of this year?

Kedar Vaze: So in the Q1 FY 2020, the Board had authorized me and Shrikant Mate to negotiate and conclude the transaction in the second half of calendar year 2020. As we tried to complete the transaction, because of the specific force majeure and situation of the industry, we could not conclude the same in that time frame. We have gone back to the Board and we will come back with a final approval and note on the same by end of February, 2020.

Suresh Jain: So is this sudden reduction of Rs. 100 crore in the debt due to this postponement of this acquisition?

Kedar Vaze: No.

Suresh Jain: The debt has come down so there is no acquisition or no major capex during the next year, so the interest cost would be down by let's say almost 25% in FY21, is it a correct assessment?

Kedar Vaze: Yes, it would be substantially lower than this year. I would just tell you again that we would do the CFF acquisition sometime next year. That will get added back to the debt. But we have strong cash flows, strong free cash flows. So the debt levels are now coming down and as the debt level comes down further, interest cost savings will further bring the debt level down faster.

Suresh Jain: Sir, during the last concall, you had mentioned that the debt levels would remain at whatever it was at the beginning of the financial year. Had you not taken the CFF acquisition into account in that calculation?

Kedar Vaze: This now, if we do not conclude the CFF before end of the year, our debt level will be below last year level.

Suresh Jain: Okay. And lastly, so due to this new accounting standard as well as commissioning of Mahad plant, our depreciation cost have gone up, if you could give a sense of how much this would be for the next financial year?

Kedar Vaze: So, it's a normal depreciation, the change was last year, now that would continue to be in the WDV method. We don't have any specific answer to what would be the depreciation would be next year. But there is no change in the deprecation from last year when there was accounting change.

Suresh Jain: So that means it would be lesser than what it is of the current year, right?

Kedar Vaze: Right.

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

Kedar Vaze: Thank you. I hope we have been able to answer all your questions satisfactorily and should you need any further clarification so I would like to know more about the company. Please, feel free to contact our team or CDR India. Thank you once again for taking the time to join us on this call.

Moderator: Thank you. Ladies and gentlemen on behalf of SH Kelkar and Co. Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines. Thank you.

-End-
