February 21, 2018

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 hereby submit transcript of Q3 & 9M FY18 Earnings conference call for investors and analysts organized by the Company on Wednesday, January 17, 2018 at 12.00 Noon IST.

You are requested to take note of the same.

Thanking you,

Yours faithfully,
For **S H Kelkar and Company Limited**

S H KELKAR AND COMPANY LIMITED
MUMBAI 400080

Deepti Chandratre
Company Secretary & Compliance Officer

Enclosed: As above

S H Kelkar and Company Limited

Q3 & 9M FY18 Earnings Conference Call Transcript
January 17, 2018

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. I would now like to hand the conference over to Mr. Anoop Poojari from CDR India. Thank you and over to you, Mr. Poojari.

Anoop Poojari Good afternoon, everyone and thank you for joining us on SH Kelkar and Company Limited's Q3 & 9M FY18 Earnings Conference Call. We have with us Mr. Kedar Vaze – Whole-time Director and CEO; Mr. Ratul Bhaduri – Executive VP and Group CFO, and Mr. Shrikant Mate – VP (Strategy) of the Company.

We will begin the call with opening remarks from the Management following which we will have the forum opened 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 to discuss the operating and financial results for the quarter and nine months ended 31st December, 2017. I will begin by taking you through the Operational and Financial Highlights of the quarter. And we will then look forward to taking your questions and suggestions.

Firstly, I am pleased to share with you that we have reported a strong operational and financial performance during the period under review. This was on back of our healthy business momentum and enhanced volumes registered in our fragrance division. As per expectation, market sentiments in the FMCG space have shown strong recovery and we are now seeing normalized demand as most GST related issues have been settled.

On a consolidated basis, our total revenue for operations in Q3 FY18 was the highest ever quarter for us at Rs. 282 crore, up 22% year-on-year. Further, our domestic revenues grew by 29% during the quarter. In the nine months FY18 revenues were stable at Rs. 737 crore, so quarterly performance has assisted us to recover from our subdued performance in the first half of the year. We expect business momentum to remain steady in quarter four which would further enable us to close the year on a healthy note.

On the profitability front, EBITDA during the quarter improved by 41% at Rs. 58 crore with margins at 20.5%. Gross margins were impacted owing to certain raw material disruption in the global fragrance and flavor industry. However, our inventory management strategy has helped us sustain supplies and meet demands of our long-term customers. Profit before exceptional items and tax during the quarter stood at Rs. 52 crore, higher by 42%. In the third quarter we had an exceptional line item of Rs. 10.1 crore of expense which is one-time expense towards the operational reorganization of PFW in Netherlands. This has impacted the PAT to the extent of Rs. 7.5 crore. Adjusted for this one-off, our recurring PAT improved to Rs. 34 crore, up 33% year-on-year and our nine months FY18 EBITDA stood at Rs. 141 crore with margins at 18.9%. Gross margins also marked a healthy improvement in line with better sales mix, PAT and adjusted for one-time expense was higher by 3% to Rs. 79 crore despite the weak first half.

Coming to the segmental performance, Fragrance division delivered a very strong performance during the quarter, registering a revenue growth of 26% and an operating profit growth of 33%. The division also saw a robust pickup on a sequential basis. During 9M FY18, domestic revenue performance in the division was stable while overseas revenues grew by 3%. Healthy market share gains in the domestic and international markets primarily aided growth during the period. The operating profit came in higher by 5% at Rs. 107 crore.

Our flavors division reported a stable revenue performance during the period under review. Domestic segment grew 10% while overseas business reported de-growth of 12% during the nine months FY18. International sales were lower owing to weaker demand in export markets, especially due to challenging geopolitical environment in Middle East, the operating profits were lower at Rs. 17 crore.

Coming to one of the major developments, we are excited to announce the acquisition of Creative Flavors & Fragrances, which is one of the leading fragrance companies in Italy. The company has a strong product portfolio in fine fragrances and particularly in the fabric care segment with solid global and regional client relationships. The acquisition represents a value accretive and synergistic opportunity for us. We believe this along with our Fine Fragrance Creation Studio in Amsterdam will strengthen our strategy to expand our presence and product offerings, primarily in the focused growth areas of fine fragrance, beauty products and fabric care. In combination with our Tanishka acquisition partnership, this gives us a very strong platform for fabric care development going forward.

Let me share some details of this acquisition. We will be acquiring 100% of the company's share capital within the next two to three years, of which 51% of the share capital has been acquired upfront for €12 million consideration. In calendar year 2016, CFF reported €13.4 million of revenue from its core fragrance business and the margin profile of this company is similar to SHK Fragrance division. This is an earnings accretive acquisition and we have largely funded it through internal accruals. Further the future investment of the remaining 49% stake will be spread across a span of three years and will be solely based on the underlying company's performance in the next three years.

I am also happy to share with you a positive development on our newly established Fine Fragrance Center in Amsterdam where we have launched our first collection of fragrances from this center. We are receiving a very healthy initial response from prospective customers. In total, with the CFF and the Amsterdam Center, we have now a strong base in Europe with which we look forward to improving traction in the premium fine fragrance category.

To conclude, we continue to execute many of our client business initiatives such as enhancing our product portfolio, improving operational efficiencies and strengthening R&D, capitalize on the large growth opportunities we have at hand.

We remain confident of sustaining or outperforming FMCG sector growth rate for years to come on the back of our leadership position in unique Fragrance and Flavor industry.

With this I 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. We take the first question from the line of Niket Shah from Motilal Oswal Securities.

Niket Shah First question was on the ingredient part of the business which we have in Netherlands and which we obviously had a plan to take a decision on that factory whether we want to shut it down and bring it to Vapi. So if you can provide any update on that?

Kedar Vaze If you look at the results we have provided for substantial reduction in the cost in Netherlands with two of the three plant lines being reduced in coming future. We have also invested in a facility in Mahad though the acquisition of VNCC where we will invest to relocate some of the production from Netherlands.

Niket Shah And when will that commission?

Kedar Vaze We expect it to commission during this calendar year towards the second half of FY18-19.

Niket Shah So, is it safe to assume that at least the ingredient part of the business which used to be a little bit of a drag will no more be a drag, and obviously with your facilities moving to India with your focus to manufacture large batch size ingredient business and kind of looking at outsourcing the smaller size, the margins in the ingredient business should move up substantially?

Kedar Vaze So, we do not track ingredient business separately because there is a large portion of in-house consumption of the ingredients, so it is very difficult to ascertain ingredient business on a standalone basis. But on your comment on the cost optimization post the Netherlands operations streamlining, we will look at somewhere between Rs.10 crore to Rs.12 crore of cost saving in the entire organization.

Niket Shah Sure. My second question was, in the press you have mentioned about 12 molecules that you are working, and you have filed for 10 patents. If you can give us some sense on when you are likely to see some commercialization and what kind of scalability some of these molecules can bring on table?

Kedar Vaze I think the molecules are key differentiators and uniqueness platform for our creations, fragrance and flavors. The molecules themselves are not being sold they are used internally. So we have already commercialized as we had announced last year or last quarter two molecules which are now in commercial use and we had already started developing additional two molecules which had already been used. So, the important thing is that we have a strong pipeline of two to three molecules per year which we will be introducing in our pallet. Consumers and flavors development team can continue to use these molecules on a regular basis going forward. Our original investment in the new molecule started way back in 2008 - 2009, we are eight years down the line and first patents which were filed in 2010, 2011, 2012 and toxicology regulations are all been done. It was a good milestone in November 2015 when our first patented molecule had a US patent granted and which has now been used commercially. And we will continue to do that going forward with every year two to three molecules being introduced and now it is a regular pipeline for us as a company.

Niket Shah And final question on the acquisition of Creative, if you could just throw some light on the synergies that you would obviously have, because if you look at SH Kelkar, it has a significant amount of integration with your ingredient business, obviously you do procure ingredients from outside as well, but does Creative also have that kind of ingredient business, if not then will there be synergies with it?

Kedar Vaze Creative is clearly a fragrance and flavor manufacturer which does not have any ingredient business. If you look at Creative, large part of its business is in Italy and the Middle East. In the Italian market, as part of European Union if you look at per capita and nature of business it is the country with lower per capita than for example Netherlands or Germany. And in that sense the product range which the CFF makes, particularly on the fabric softener and detergent range, our products are the premium products in emerging markets. So, we will carry a direct library of premium fabric softener and fabric detergent powder or liquid detergent fragrances developed for Italian market which we can use in India, Indonesia and Middle East. In addition, we have built the technology for encapsulation of fragrances for fabric use and we are going to sell that technology in Italian and European markets using this platform.

Niket Shah And on profitability, any synergy that you see on profitability improving?

Kedar Vaze Before profitability, because of the Italian acquisition and our own investments in Amsterdam now, we are at the cutting edge of premium fine fragrances development. So we have now the tools between Milan and Amsterdam which are fashion capitals. And the access to the premium ingredients as well as the sources from people point of view who make all the specific requirements of premium fine fragrances on a global basis. So that is as far as the synergies on the development side. In addition, we will definitely have cost synergies on procurement and purchasing and quality systems and regulatory costs which we can apportion to both the businesses together.

Moderator Thank you. We take the next question from the line of Jignesh Makwana from Asian Market Securities.

Jignesh Makwana Just have a question on Creative acquisition, do they have a manufacturing facility and are we going to shift that manufacturing facility in India in the near future?

Kedar Vaze No, CFF has a manufacturing facility in Italy that will continue in Italy, we have no immediate plans to move it to India. Typically, fragrances business requires very short lead time and you are able to respond to the market demand. Having facility in each market helps us to react quickly to the market demand. However, it is early days for CFF in terms of synergy and product mix. So if there are products which can be manufactured in one location and sold in various parts of the world, we will optimize the operations going forward. But as of now, there are no plans to optimize or change any production, scheduling of production plan in CFF, it will run as standalone operations in European market.

Jignesh Makwana Okay. And in terms of sales mix, if you could provide me the Creative's mix between fragrance and flavor?

Kedar Vaze It is largely 95% fragrance.

Jignesh Makwana Okay. And you have mentioned, there was some short-term disruption in raw material front, can you please elaborate it?

Kedar Vaze In the period between September, October and early part of November there were various feedstock supply chain disruptions, obviously in China there was a major crack-down on environmental factors and environmental clean-up because of which many of the chemical plants were asked to shut down or were closed for operations for three to four weeks' period. There was a large impact due to the storms in Florida which resulted in shut-down of plants in Florida affecting our supply chain. And to top it all, there was a large fire in a plant in Germany in BASF; this forced them to declare a force majeure. To give a context, BASF is roughly 20% to 25% of volume of industry's raw material purchase. So when such a large volume of product becomes unavailable there are huge disruptions in the market place as far as ingredient supplies are concerned.

Jignesh Makwana Okay. And when can we expect normalcy?

Kedar Vaze For us, just to complete the picture, we have no supply disruption to our customers or to our supply chain, we have sufficient stock inventory. And our inventory planning has enabled us to maintain continuity of supply without disruption. On the normalization, there is a period, we will have to wait and see what actually plays out when the plants recover or restart. But I would imagine by third quarter of the calendar year which is second quarter of the next financial year, things will be more in line with normal trajectory. We will be in a good position during this period as we have inventory in hand, with that inventory we will be able to supply uninterruptedly to our customers throughout this period.

Jignesh Makwana Okay. And just wanted to understand on flavors side, our margin has been very volatile over the last few quarters, so when can we expect normalcy in the flavors margin?

Kedar Vaze Flavor margin has been very much affected by the orange oil prices going up and hence, some of the business on the orange flavor we have curtailed as the margins are too low. So you see as partly revenue loss in this quarter also on the flavor which is to do with the same phenomenon of orange oil prices and margins below a certain level. So this will happen much more in flavors because we have a concentrated portfolio as compared to fragrances. But the overall 21% - 22% EBITDA level is what we are managing on an average long-term basis. Last year third quarter was a very good quarter in terms of the margins, we had almost 30% EBITDA, but that was also including one-off raw material benefits. This quarter this year there are one-off raw material losses, so if you compare like-for-like it looks like avery big swing. But we are maintaining our average of 22% - 23% EBITDA level in flavors.

Jignesh Makwana Okay. But do we have a pass-through in flavor segment or fragrance segment, raw material inflation pass-through?

Kedar Vaze Yes, I have mentioned this numerous times and just to reiterate, we have six months to one year contracts with our customers and we update the prices as and when there are major cost increases or situations where we plan to increase prices. The raw material scenario we try and make it average of the previous six months and then negotiate and discus with the customers.

Jignesh Makwana Lastly on the Creative fragrance, how has been the performance over the last five years for Creative?

Kedar Vaze I have data for the last three years in specific detail, it is in terms of INR about 10% or 11% CAGR growth and margins of the business have been around 20% EBITDA level. It is very similar business in terms of the nature of business as our own domestic fragrance business. We have many diversified large number of smaller or mid-size of private label customers, it is not dependent on any one business for the core fragrance business. And it really is a good synergistic acquisition; it will drive product development for our emerging market and our premium technology products like the new molecules and encapsulation where the market is not yet ready in the emerging markets we can use those technologies and those products to be sold in European market via the Italian acquisition. This gives us an outlet for our premium development and to take their development as ready library for our markets.

Jignesh Makwana Okay. So, you said 10% to 11% in INR terms, but what would be growth in constant currency for the Creative over last three years?

Kedar Vaze It was 6% growth.

Moderator Thank you. We have the next question from the line of Prakash Kapadia from Anived PMS.

Prakash Kapadia On the demand side what is happening on the domestic side of the business, if you can share some thoughts on which segments or sub-segments are growing, which are not growing, any key client addition on the fragrance business for us?

Kedar Vaze I think particularly on domestic fragrance business, we have pretty much all the clients, all the large FMCG or key FMCG players are clients of ours. There is no new addition in terms of clients, but we have obviously new products added to the client portfolio on a continuous basis. What has happened is as we talked about it last time, a lot of the new product developments or the new approvals did not get launched in the period of last three quarters owing to various macro-economic factors like demonetization and impact of GST, a lot of companies deferred launching of new products. Now, all of the products which are approved and ready for launch are all seeing the light at the end of the tunnel and this quarter we have seen robust demand across all sectors, all the key customers have continued to grow their existing products as well as introduced new products. And on a long-term trend, we have been looking at a 15% CAGR growth year-on-year. Barring the last two or three quarters which was disturbed because of other reasons, I think the underlying growth is intact. So I do not see any structural change, in fact it is back to normal.

Prakash Kapadia This momentum is here to stay and it should continue?

Kedar Vaze Yes, this is the new normal. I don't think this is an abnormal quarter, it should have been this quarter anyway and we had abnormally low quarters in the past.

Prakash Kapadia On the distribution side, if you could share some insights, how are smaller distributors, stockists, is the GST part of disruption all done, are they part of the ecosystem, value chain, have they all adapted?

Kedar Vaze As far as distributors of our products they have all adapted on immediate basis so they had no real hiccups on GST. But I understand that the FMCG where there is large number of chains - wholesaler, retailer and so on and so forth - had more time to adjust. And purely based on the demand and the manner in which business is restored these things would have been sorted out and I would say it is business as usual plus because the demand is stronger than what it would have been in a normal scenario.

Prakash Kapadia And on the PFW aroma, any other costs which are still to be provided or are we done with Rs. 10 crore ?

Kedar Vaze So, as far as the accounting standards, this is on accrual basis, so the entire Rs. 10 crore is not paid in this quarter, it will be paid over remaining period till it is operating. But the costs are all provided for when the decision has been taken. So we have provided total cost of relocation and redundancy upfront.

Prakash Kapadia Okay, so that is the total cost. And lastly, if I look at nine months numbers year-to-date, and if I look at EBITDA or pre-exceptional profit, or be the Rs.10 crore hit that we have taken in the P&L, there has been a 3% - 3.5% kind of growth of Rs.122 crore as compared to Rs.118 crore. So, as we move forward towards FY19 this EBITDA in pre-exceptional profit should grow in line with sales growth, is that fair to assume for FY19 and onwards? And any impact we are seeing on rising crude prices?

Kedar Vaze So, I think the rising crude prices and raw material cost increases are something which are exceptionally high, as I mentioned earlier in this quarter. We are talking and already in discussion with our customers. We will continue to be in contact and buffer to try and make as best possible win-win situation out of this. But for the revenue and margin basis we should not look at the nine months as an indication for the future because the first half of the year was subdued than normal. I would say that this quarter is a better indication of things to come.

Prakash Kapadia Okay. So, at least going forward we would expect the longer-term aspiration which you have always been talking of, sustainable 15% kind of growth in terms of sales, so that 15% should translate into 15% kind of number.

Kedar Vaze Yes, absolutely. I think where we are in this quarter for example there is no price increase or anything, revenue is completely volume gains. So we see that this is a very strong demand signal.

Prakash Kapadia If this raw material kind of concern remains, when would we typically think of a price hike, will it be in Q4, at the year-end, typically how does pricing change happen for us?

Kedar Vaze It happens typically once a year normally in January-December cycle, with the exceptional situation which we are witnessing now it may be more than once a year if we are faced with force majeure or major inflation on few raw materials we will pass it on and we will discuss with our customers how we can enable to have a smooth transitioning.

Prakash Kapadia So, have we taken price hikes in January?

Kedar Vaze We have already communicated at various stages of negotiation, but typically it is an annual cycle and we probably may do price increase two times this year if the inflation remains as it is.

Moderator Thank you. We have the next question from the line of Rajesh Kothari from AlfAccurate Advisors.

Rajesh Kothari My first question is, Rs. 10 crore write-offs that we have made, goes under which segment in segment reporting?

Kedar Vaze We report it under international fragrance.

Rajesh Kothari So, instead of Rs.39 crore PBIT actually it is Rs.49 crore PBIT?

Kedar Vaze It will be taken in corporate cost and it has been deducted from the total fragrances.

Rajesh Kothari So, it means your PBIT in fragrances is Rs.49 crore if you add back the Rs.10 crore one-off expense?

Kedar Vaze That is right.

Rajesh Kothari If I look at PBIT margins on normal basis without this one-time expense then fragrance PBIT margins are 19.2% compared to your second quarter which was 16% and last year it was very low. So I am just trying to understand that in terms of the business how do you look at the PBIT margins going forward for both the segments, flavors and fragrance?

Kedar Vaze The PBIT also depends on the momentum and the sales revenue of each period, because there obviously is a period cost. On the gross margin level, the EBITDA level we will continue to do 22% - 23% on both fragrances and flavors.

Rajesh Kothari Okay. And second question is with reference to the new company which you have acquired, CFF, was it profitable?

Kedar Vaze Yes, it had 22% EBITDA for FY16 and we believe it is very similar for FY17, though we do not have the audited numbers.

Rajesh Kothari But does it have any major loans kind of things, interest cost and taxes, in the sense that at net level what kind of report it is reported?

Kedar Vaze There are no large loans, there is working capital loan of around €4 million - €5 million, exact number we will get in the audited accounts at end of December. But the loans are maximum €5 million or €6 million. Our acquisition has been through internal accruals, so there is no additional debt on the CFF acquisition.

Rajesh Kothari So is this the first time you are entering into fabric care segment?

Kedar Vaze No, we are very much present in fabric care, fabric care covers detergent powder, detergent liquid, detergent fabric softener. We are already present in this market. As these markets are now getting consolidated and the per capita income of these markets in emerging market increases we see the first direct correlation of that is in terms of quality or premium pricing of the fabric care products. We are now ready to bring the library of the Italian acquisition to emerging markets like India and Indonesia, we can use these models or these bases, customize them for Indian and Indonesian and Middle East markets rather than starting from scratch.

Rajesh Kothari What is the size of fabric care portfolio right now before acquisition?

Kedar Vaze About 10% of our fragrances are in fabric care.

Rajesh Kothari Okay. So, on a three-year basis how do you see this portfolio?

Kedar Vaze We will immediately be able to use their library of fabric care fragrances in our markets, so we save a lot of time on development. If you see the result of what is happening in the last two, three years and as a result of GST, per capita or economy growth, particularly in India and Indonesia, the rate at which the products, new products, premium products are getting introduced is much faster than in the past. With this, we already have a ready library for fabric care and home care which we can use in our markets. There is a three to four years of research time and that is very critical in the market place today.

Rajesh Kothari Okay. Would you like to give any kind of a number you are doing three to five years in terms of your total portfolio, how big this can be considering these new acquisitions?

Kedar Vaze The number is still the same, we will still do a 15% CAGR. But our ability to win in the market place on the new product development is substantially enhanced. If our win rate in fabric care was 10% or 15% I think we should be able to do a 25% win rate in the next two to three years. It will increase our revenue after that period, because this is going into research and output of that will happen two years from now.

Rajesh Kothari Okay. And on Netherlands can you give some color in terms of what is the first nine months what is the revenue and how deep was EBITDA before this write-off? And as you are shifting your production facility do you see Rs.10 crore - Rs.20 crore savings, by when will we see this, do you think FY19 we will see Rs.10 crore to Rs.12 crore kind of cost savings?

Kedar Vaze Netherlands business is not tracked separately, the legal entity is one, but we have a lot of inter-company sale for our products, locations and that is sold via Netherlands and from Netherlands to India and back and forth. It is safe to say that the entire operations which was in Netherlands has been absorbed in our India operation to the extent that was possible. And by the time we have our plant in Mahad ready by second half of coming financialyear, we will be able to further optimize and streamline our Netherlands operations. Net to net on an annualized basis we anticipate between Rs.12 crore and Rs.15 crore of cost savings, and there will be some additional cost of warehousing and so on and so forth once we move to India. But on a total like-for-like basis, once the entire implementation of the reorganization is done, we should save between Rs.10 crore to Rs.12 crore of cost.

Rajesh Kothari So, from October 2018 you are thinking that that will come through, so in FY19 may be Rs 5 crore - Rs.7 crore kind of cost savings and balance will be next year?

Kedar Vaze Yes.

Rajesh Kothari The balance will be FY20, that is what you mean?

Kedar Vaze See, the full year impact will be Rs. 12-odd crore.

Rajesh Kothari Okay. My last question is, if you look from overall growth perspective in last five years, some segments are not growing and therefore overall revenue growth is a bit muted considering demonetization and then GST which has its own adverse impact. So over next three to five years on a normalized basis while you keep mentioning 15% kind of a growth, but if you keep adding acquisitions then why can't we do 20% to 25% compounded growth in revenue terms?

Kedar Vaze Yes, the part which you mentioned is very relevant, we are looking at 15% CAGR growth where we have our own visibility of markets and demand, and what we can plan and execute. There will be opportunities for acquisition and we can use them to further leapfrog our growth. So the 15% which we talk about on a long-term is not based on acquisition strategy, it is based on organic growth strategy.

Rajesh Kothari Okay. And when you do 15% organic growth and your focus is on new product innovation, reducing cost, Netherlands, so on and so forth, do you think your EBITDA growth will be little bit faster than your revenue growth?

Kedar Vaze Yes, that is true. When we look at the EBITDA growth, it should be little bit faster than the revenue.

Moderator Thank you. We have the next question from the line of Varun Balachandran from Catamaran.

Varun Balachandran Few follow-on questions linked to what was asked earlier. So one on CFF, you mentioned that 95% of the business is in fragrances, could you give a sense of how much of that is within fabric and how much is fine fragrances?

Kedar Vaze So about 10% is fine fragrance.

Varun Balachandran And fabric would be the rest?

Kedar Vaze 35% is fabric and 30% is home care.

Varun Balachandran And you mentioned that the library of fabric and other segments is something that you can bring to clients in India as well as in Indonesia, etc, how much time do you see that process taking and what would it take in terms of say manufacturing or other support function to make that happen?

Kedar Vaze So, we have all the manufacturing and support everything in place, this would have normally taken us two years to develop in-house, we will catapult and be ready with the products much earlier. We are saving on our R&D cost, time, more than cost the R&D time because we are starting with ready prototypes, we are bringing existing premium models from overseas to emerging markets.

Varun Balachandran And in terms of the library of CFF, how many patented molecules or any of those sort of things they have?

Kedar Vaze They do not have any ingredient manufacturing or ingredient research.

Varun Balachandran And the other question was on the domestic fragrance business, you had earlier spoken about the business split in terms of larger clients on one end and then the smaller B2C or retail customers on the other side and the regional customers in the middle, right, so the ABCDE. Could you give a sense of the growth in this last quarter across these different segments?

Kedar Vaze I do not have a specific growth analysis on the ABCDE, however, when we do a product level analysis all the products have grown, there is no specific segmental or specific directional change. So we do not see any specific kind of regional growing faster or larger global growing faster or consumer growing faster, all three of them have restored growth to the same level, so we do not see any impact of product mix or segmental change in this transition.

Varun Balachandran And in terms of growth has the smaller pack resumed growth in terms of they were the most impacted by GST, has that recovered as well, the smaller customers?

Kedar Vaze Yes. I mean if we had no historical collection of GST, this quarter would have been just normal. Two years back if you had asked me this quarter it is as per budget for each segment, each area within a (+/- 5%) range, we are on a long-term track.

Varun Balachandran And in terms of hygiene any one-off revenue in this quarter or they are all more recurring with typical revenue cycle?

Kedar Vaze Only one-off costs.

Varun Balachandran Lastly on the flavors business, year-on-year it looks like for flavors in domestic the growth has sort of tapered off, particularly in this quarter. Could you talk a bit about that and the traction that we are seeing there as well as may be a bit of the distribution?

Kedar Vaze No, it little bit looks like that because of the combined basis. We have orange oil as I mentioned where the price increase is very substantial. And we have a product mix change where part of the orange oil or orange flavors have been reduced in the product mix. So, in that scenario, the overall organic growth is still in excess of 20% with attrition of one product where the margins were very slim anyway.

Varun Balachandran Okay. So a volume growth of 20%, right?

Kedar Vaze Yes.

Moderator Thank you. We have the next question from the line of Chanchal Khandelwal from Birla Sunlife Insurance.

Chanchal Khandelwal Most of my questions have been answered, just one thing on the crude impact. If you see your past history how has this impacted and what is the time lag in which you can take a price increase? And second thing on the acquisition front, which are the clients you supply, you must have done your due diligence in terms of supply, as in the clients based there is there any client present in India? For example, do you supply to Unilever or Procter, any of the global MNCs there?

Kedar Vaze As I mentioned their business model is also very similar to our business model, so they are working with regional players largely in Italy and Middle East.

Chanchal Khandelwal No global MNC clients?

Kedar Vaze No global MNC client in their core fragrance business. As part of their business, they also do tolling work for other companies.

Chanchal Khandelwal And on the crude related thing, margin impact?

Kedar Vaze Crude, normally crude related we have N+2 or N+3 downstream product which are used in our industry, so the crude impact is felt only after five or six months. And typically, it will be only to the extent of 10% or 12% of the increase. So if there is an increase of 50% we will have increase of 10% or 12%. And we have enough time, indication, lead indicators on the crude price to pre-emptively go back to the customers and negotiate with our vendors to have the best smooth curve on the raw material and selling prices.

Chanchal Khandelwal Sir, last year the domestic flavor business, there has been a big opportunity, what is preventing us to scale up, I mean it is a difficult category to crack but if you can just highlight what are we doing in terms of flavor?

Kedar Vaze So, we are growing in more than 25% CAGR organic growth, we are doing everything that it takes. It is just a matter of time, in the flavor business even like all the business which we do there is a one to one lock-in of the brand with the flavor or with the fragrance. So it is one-product-at-a-time kind of business, we cannot ramp it up with one product which sells to all the customers, for each customer, it is a tailor-made product so we need to go step-by-step. Just to add, we are doing double the market growth in the last five years and we will continue to grow our market share on flavors in a sustained manner. We are committed to the business, we are committing to resources from development and infrastructure for manufacturing. So this is ongoing business which we continue to support and grow.

Chanchal Khandelwal And how much percentage UAE or Middle East for this flavor business?

Kedar Vaze From the flavor business roughly 40% to 45% is exports business in a year. If you look at the exports business typically that business is more lumpy, in the sense because it is full container, we do not supply month-on-month, in one month we may have more supply and in another month we may have less supply as per the production scheduling of our clients. So it does not track very well on a quarter-on-quarter basis. But if you look at annualized 12 months moving average basis, it continues to be at 25% CAGR growth even for the exports.

Moderator Thank you. We have the next question from the line of Chirag Dagli from HDFC Mutual Fund.

Chirag Dagli Sir, what explains this 22% sales growth, is this largely volume lead?

Kedar Vaze We have no specific price increase except for a few products, so it is largely volume growth.

Chirag Dagli Okay. And you think at least till such time that this low base sort of lasts this momentum is sustainable?

Kedar Vaze I would just comment that if you compare quarter three last year that was a subdued quarter on account of demonetization, now whether it was subdued by extent of 5% or one month, it is very difficult to ascertain. But I would not think that this quarter was any exceptional quarter, we have seen normal business restoring back to normal. The result of that 22% growth over last year quarter we should have seen a 14% - 15% growth on a normal growth basis anyway. Third and fourth quarter typically are the strong quarters as new products get introduced and there is full ramping up quarter. So third and fourth quarter typically are stronger quarters for us and this year is no exception.

Chirag Dagli In the segmental disclosures, for the nine months there is a Rs. 10 crore unallocated expenditure which is very large versus last year. If you can give some color on what this is about.

Kedar Vaze When you are looking at nine months it also includes cost relating to acquisition and closure, so a lot of legal consulting and so on and so forth which we cannot take as direct cost in the segment, these are corporate costs relating to acquisition plus the PFW closure cost which is higher than normal.

Chirag Dagli So the PFW closure cost of about Rs. 10 crore is included in this line item?

Kedar Vaze No, that is separate, that is the actual payment to the employees which can be allocated to the individual segment. The related legal, consulting, merger and acquisition considering due diligence, number of one-off cost, stamp duties, agreement cost, all of the cost related to both the acquisition and the PFW closure discussion with the trade unions so on and forth, they are all one-off cost.

Chirag Dagli So in next quarter will this normalize …?

Kedar Vaze Yes, at Rs.3 crore to Rs. 4 crore a year.

Moderator Thank you. We have the next question from the line of Nishna Biyani from Prabhudas Lilladher.

Nishna Biyani Just wanted to understand the rationale for buying CFF at this point in time and what was the reason of that company to be sold?

Kedar Vaze Rationale?

Nishna Biyani The seller, why was he a willing seller and what benchmark you used for buying this?

Kedar Vaze In terms of the history of this company, there was an original promoter family in which unfortunately the senior generation passed away and this was owned by private equity for the last five, seven years. They are private equity or the equity holder is the one who is now selling it to us as a sale to a strategic partner. Seven or eight years ago the original promoter of this company passed away, an elderly gentleman, so they moved hands into a financial investor who was looking to exit.

Nishna Biyani What was the benchmark in terms of valuation?

Kedar Vaze So, there is a strong flavor of an earn-out and a second 49% which is based on the performance. But the initial benchmark has been looked at as nine times of sustainable recurring EBITDA, which is more or less the average of industry standards in the previous years. So that was sort of benchmark. The last one or two deals have happened at higher EBITDA multiples, long-term average multiple of between eight to nine times EBITDA has been taken as a benchmark.

Nishna Biyani Sure. And if you could let us know when the payout of this Rs. 93 crore happen and when shall the numbers get consolidated with the main SHK?

Kedar Vaze So the acquisition happened on the 15th, so 51% has been acquired as we speak. We have still to look at the accounting standards from a consolidation because the management control remains with the current management. We need to get the final audited numbers for March and then discuss with their auditor and our auditor in terms of what is the accounting treatment for consolidation. Although we have acquired 51%, current management will continue to operate the business for the next two or three years till we consolidate 100%. So we are not 100% clear on the accounting treatment on when it will get consolidated.

Nishna Biyani Sure. So, just what is the legal opinion in terms of NDAs, does that 51% get share of associate or how does that accounting happen?

Kedar Vaze As of now we are treating it as investment and we will account for it as a share of profit in this last quarter. And we need to make sure that we have the agreements with the management in place to allow us to demonstrate management control. So currently it is a 51:49 JV and we will account for it as a JV. Now whether we have the management control or not, it will be decided based on the grading of the agreement. The intention is that we will take over the entire company in period of two to three years, so there will be a transition and management control. Only when we will take that management control in accounting terms is something which we need to get the clarity with the auditors of both companies.

Nishna Biyani And sir my last question is in terms of you have been continuously highlighting in the past that the business has the potential to grow 15% for the next decade. Just wanted to understand what is the risk in your growth thesis, if at all?

Kedar Vaze The demand side I do not see there is a huge amount of risk, we are talking about 3 billion people in this region with an increasing per capita income. So we see that demand materializing in the next decade and more. The opportunities are there, the challenges are always to make sure that we make the most of the opportunities. So we need to continuously invest in R&D, for example the CFF has given us a library on fabric care which is one or two years ahead of the library that we would be developing today. So this is leapfrogging us, keeping us aware and ready to take maximum growth as it comes up. So this is the kind of investment, kind of research and future looking research and development investments which we need to do to make sure that we do not lose our market share as the opportunity comes in.

Moderator Thank you. Our next question is from the line of Aejas Lakhani from Money Mind Financial Consultancy.

Aejas Lakhani Sir, my first question is broadly on capital allocation. So in the last two years if you look what the management has done is that we have some plans, like Vapi, Raigarh or Mumbai which are operating at lower capacity utilizations. So in terms of capital allocation, deploying capital to increase operational capacity vis-à-vis buying acquisition, what is the broad thought process of the management on that?

Kedar Vaze One thing which the management believes and we need to look at is capacity utilization on five years down the line utilization level, because we will continue to grow and we need to have at all times capacity ready for future growth. So we will invest ahead of the curve keeping capacity ready for the growth. Because in terms of emerging markets, we need to have the capacity in hand to build the market. We will miss big opportunities if we do not have capacities in hand. Having said that, large part of our capacity investments has already come in place. We will now look at investments in equipment or operating investments where we have strong return on capital invested basis where we can save on cost or increase our revenue accordingly. And surplus cash flow, we are always looking, and we will continue to keep our strategy of tuck-in or partnering.

Aejas Lakhani Okay. And sir my second question is that if you look at the industry in general, your industry players are expanding, the likes of your international guys are increasing capacity. And on the other side even the compliance and regulation cost seems to be going up. So, on one hand we may have a situation of pricing power challenges because of capacity expansion and on the second side we are seeing compliance and regulation cost going up. So, will that result in a relatively more squeezed margin, obviously adding to the fact that to the point you addressed earlier regarding gross margin.

Kedar Vaze The industry is very low capital investment for capacity and it is very low cost on regulatory cost of total product. So, both of these factors while they are increasing, the base of that is very small, so there will be no net impact on our gross margins as a result.

Moderator Thank you. We have the next question from the line of Anand Shah from Kotak Securities.

Anand Shah Sir just two questions, one, your exports or the overseas business essentially this quarter seems to have grown at a brisk pace. So what is driving this and is it sustainable or are there any one-offs? And second part, on the domestic fragrance side, can you highlight what is your service income? In the past few quarters you did highlight post GST you may see some disruption on this servicing part, so any change on that?

Kedar Vaze Service income is in line with normal quarter, roughly around 12 crore and there is no disruption so far in that business model or in the income. We had highlighted that the discussions with customers will happen over the next one or two quarters if there is any change in their business model. As of now, there is no change. In regards to your second question on international fragrance, if you remember end of last year, we had taken a very conservative policy as far as credit risk in international markets given what was happening particularly in Africa, Middle East and these pockets of markets, geopolitical and currency risk. So, we were very cautious in terms of our ability to extend credit beyond a fair basis. We saw a two to three quarters of flattish growth because some of the long credit customers needed to be convinced on the new policy. And we have seen in this quarter that the growth has now started and resumed, and I am very happy and pleased to also inform that we have very strong credit policy now in place for international fragrance because we had a situation few years ago when few of the doubtful debts hit our provisioning. We have been able to grow now on a basis where the credit risk or the nature of credit is substantially better, and we are now on the new track where we start growing on that platform.

Anand Shah Okay. Any specific markets which are seeing good growth?

Kedar Vaze Indonesia and Middle East, both these markets seem to have recovered.

Moderator Thank you. Well, that seemed to be the last question. I now hand the floor back to the management for their closing comments.

Kedar Vaze Thank you. I hope I have been able to answer all your questions satisfactorily. Should you need any further clarifications 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.

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