



“Shankara Building Products Q1 FY18 Results Conference  
Call”

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**Moderator:** Ladies and gentlemen, good day and welcome to Shankara Building Products Limited Q1 FY'18 Earnings Conference Call. This conference call may contain certain forward-looking statements about the company which are based on the beliefs, opinions and expectations of the company as on the date of this call. These statements are not the guarantees of future performance and involve risks and uncertainties that are difficult to predict. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal for an operator by pressing '\*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sukumar Srinivas – Promoter and Managing Director from Shankara Building Products Limited. Thank you and over to you, sir.

**Sukumar Srinivas:** Thank you very much. A warm welcome to all of you this morning for our Maiden Earnings Call to discuss Financial and Operations Performance of the Q1 of the Financial Year 2018.

I am joined by Siddharth Mundra, our Chief Executive Officer, Alex Varghese, our Chief Financial Officer and Strategic Growth Advisors, our Investor Relation Advisors.

This being our first concall, let me take this opportunity to give you an “Overview of our Business Model” followed by the “Key Highlights of the Last Quarter”, post which we can open the floor for “Questions.”

Our company’s sale is broadly classified into three segments -- Retail, Enterprise and Channel. Let’s first start with the largest pie in sales which is the Retail segment and which is also the key focus of our company. We are one of the leading organized Retailers of Home Improvement and Building Products in India based on the number of stores which we operate under the trade name of “Shankara Buildpro.”

The target audience for this segment comprises of Individuals, Home Users, Professional Customers, Home Improvement Customers, Professional Customers like Architects, Small Contractors and the like.

We have a large range of products with an access to more than 100 brands and 20,000 plus SKU. This includes in-house as well as third-party products. As we speak today, our presence is across 114 stores in 9 states and 1 union territory in India. Majority of our stores are concentrated in South India and we intend to further consolidate in this part of the country.

What makes a Retail model unique is the availability of a large number of Building Products under one roof with the advantage of trust, authenticity, selection backed by an efficient backend supported by in-house, warehouse and logistics. This model becomes highly scalable due to its location presence which comes at an extremely competitive operating cost. Our average rental cost per sq.ft per month is around Rs.16 to Rs.17 and an overall operational cost are around 2% of our sale. Our Retail sales have grown at a CAGR of around 27% over the last five years and

contributes to 42% of our overall sale for the financial year 2017. This we expect to ramp up and the share of the Retail sale has gone up to around 46% in the first quarter of this financial year 2018.

I shall now move on to the other two segments which are the Enterprise and Channel sales. Enterprise segment mainly caters to the requirements of end users, contractors and the OEMs. In the Enterprise sales, we largely process Steel Tubes, Pipes, Strips, Color Coated Roofing Profile, and Accessories through our processing facilities spread over 12 locations. This formed around 33% of our consolidated turnover in the financial year 2017 and remains around 32% in the first quarter.

The next segment is our Channel sales where we have a network of around 2,000 dealers to whom we cater our in-house and third-party products. Channel sales gives us great insights to understand market dynamics, consumer behavior, products and brand acceptance. This business formed around 25% of our consolidated turnover in FY'17 and have come down consciously to around 22% in the first quarter of this year. Our front line businesses are well supported by in-house supply chain comprising Fleet of owned Trucks, Warehousing, ERP Systems and MIS Systems for efficient inventory management and timely delivery to customers.

In the coming years, we expect Retail business to scale up as we are in the process of introducing many brands in our Retail stores, and at the same time, increasing the product offering to our customers.

We expect Enterprise sales to be stable and the Channel business to trend lower.

With this brief introduction, I would request Siddhartha, our Chief Executive Officer, to take you through the Quarterly Performance. Over to you, Siddhartha.

**Siddhartha Mundra:**

Thanks, Sukumar. So during the first quarter of financial year 2018, the total revenue stood at Rs.592 crores, up from Rs.567 crores the same quarter last year by around 4.4%. The other expenses for the last quarter were down by around 10% on account of scheduled maintenance activities in our processing facilities. Our EBITDA increased by 18% to Rs.39 crores YoY. EBITDA margin saw an uptick of 78 basis points to 6.6%. Finance cost decreased by around 17% YoY on account of better working capital management, reduction in interest rates and repayment of loans from proceeds of the IPO. This reflected in our PBT numbers which saw an increase of 40% to Rs.27 crores from Rs.19 crores for the same period last year. PAT stood at Rs.17 crores for the quarter, up by 33% over the corresponding quarter last year.

Let us move to the Segment-wise performance: Retail sales grew by 21% to Rs.270 crores during the first quarter of FY'18 as compared to Rs.223 crores for the same quarter last year, it contributed 46% of the total revenue of the company. EBITDA in Retail increased to Rs.30 crores in Q1 FY'18 and the margins expanded by 160 basis points to 11.2%. The same-store sales

growth stood at 15% for the Q1 FY'18. Average rental cost for leased outlet stood at Rs.16.6 per sq.ft per month. Of the overall 112 stores that we had in our network at the end of Q1 FY'18, 96 stores were on a leased basis. Our overall rental expense as a percentage of our revenue for the Retail segment stood at 0.57%. Major portion of our sales came from Tier-3 cities which contributed to 40% of the overall revenues, followed by Tier-1 which contributed to 37%, followed by tier-2 which was 23%. Average ticket size per transaction stood at Rs.22,962 as compared to Rs.21,112 for the same period last year. As of now, we have an overall network presence of around Rs.4.05 lakh sq.ft. We have very focused approach to upgrade our stores and make most of the wide products and brand available to our customers. We conduct trainings for our internal staff to also improve their product know-how.

In addition, we have annual plan to increase our Retail presence by 15-20 stores every year and we target to breakeven from our new stores within 12-months of their starting operations. These new stores would be largely operating in South India where we have strong brand visibility and customer acceptance. As we add new stores, we are also in the process of upgrading our existing stores to carry our enhanced product portfolio.

Moving to Enterprise Sales: This segment sales stood at Rs.191 crores down by around 1.3% compared to the same quarter last year. It contributed 32% of the consolidated revenue of the company. The segmental revenue was largely flat as we continue to increase our focus on customization opportunities.

Moving to Channel Sales: This segment's revenue stood at Rs.131 crores, down by 13% compared to the same quarter last year. It contributed 22% of the overall revenues of the company and this aligns with our strategy of consolidating this business and focusing on businesses with better return profile. The number of dealers in this segment stood at approximately 2,000 as on 30<sup>th</sup>, June 2017.

Shifting our focus to the Key Highlights of the Processing and In-house Supply Chain: The company has 12 processing facilities with capacity utilization of 91% for the quarter. Sales from our own products accounted for Rs.328 crores, that is around 55% of the total sales in Q1 FY'18. As on date, we have 44 number of own trucks and 56 warehouses.

To conclude, we believe we are well-positioned to capitalize on the growing demand for Building Products to make available and deliver a wide array of products, optimize the Retail presence and benefit from the organized push that India will see in the times to come.

With this, I open the floor for discussions.

**Moderator:**

Thank you very much. Ladies and gentlemen, we will now begin with the question-and-answer session. First question is from the line of Rajesh Kothari from Alfaccurate advisors. Please go ahead.

- Rajesh Kothari:** Just want to check in terms of same-store growth. In the first quarter it has been about 15%. So what is your guidance for the full year because earlier I thought it used to be higher, am I right?
- Siddhartha Mundra:** So we have recorded much higher sales growth in the past, but Q1, there were certain difficulties that came in especially in the month of June on account of the GST roll out. There were lots of basic difficulties in terms of uncertainties, pricing, etc., so I think that was some impact. But I think going forward this should be a reasonable number to kind of continue to focus on.
- Rajesh Kothari:** So is it the market back to normalcy or it is still going through some pain of GST?
- Siddhartha Mundra:** I think now it is returning back, I think July also was a bit of an uncertain environment.
- Sukumar Srinivas:** I think from the third week of July, things are pretty much normalized.
- Rajesh Kothari:** So can you achieve your earlier track record of 18-20%?
- Sukumar Srinivas:** I think we should be able to bounce back to that in terms of sales growth definitely from Q3.
- Rajesh Kothari:** If you can just give us some color in terms of old stores versus new stores? What are the product mix changes, whether the own goods versus the outsourced goods significantly changed between the new format and the old format? And how many stores are upgraded, and how many stores will be upgraded over the next 12-18-months?
- Siddhartha Mundra:** Our stores were carrying product category largely in our legacy products that we have. As we are continuing to increase our product portfolio and upgrading our stores, we are adding a number of categories like Plumbing, Sanitary Ware, Electricals, Flooring, Interior, Exterior, etc. So that product portfolio definitely shifts in terms of the newer store roll outs. We have upgraded around 10-stores in the last quarter; Q1 FY'18 and we would look to end the year with around 30-odd upgrades for the full year.
- Rajesh Kothari:** So what are the total upgraded stores as on first quarter end?
- Siddhartha Mundra:** So that would be around 20.
- Rajesh Kothari:** So 20 plus another 20, basically, total 40 will be upgraded by March '18. That is what you are trying to say?
- Siddhartha Mundra:** Yes, that is right.
- Rajesh Kothari:** By March '19?
- Siddhartha Mundra:** We are looking to upgrade on the same momentum of around 30-stores per year. So we are looking to do the same numbers in next year as well.

- Rajesh Kothari:** Between upgraded store and old store, how the product mix changes in terms of your own goods versus outsourced goods? Right now I think 55% is through your own manufacturing on average basis, but in a new store, how much will be your own manufacturing?
- Siddhartha Mundra:** So in a new store, it will be lesser because in the newer product categories, we do not have our own backend integrated facility.
- Rajesh Kothari:** So will it be like 75/25?
- Sukumar Srinivas:** End of the first year I would say it would come down to that.
- Rajesh Kothari:** As the outsourcing component keeps increasing, that also means better return on capital employed?
- Siddhartha Mundra:** That is something that should kick in, but let us see when it kicks in actually.
- Rajesh Kothari:** For a upgraded store whether the capital employed per sq.ft. for example is lower compared to your old legacy store?
- Siddhartha Mundra:** No, I would not say that the capital employed per sq.ft. will be lower, but it may be slightly higher, but then the profitability is also commensurately much higher. So I think from a capital efficiency perspective, we may be better off with these upgrades.
- Rajesh Kothari:** Can you just elaborate why the capital employed would be higher in new stores because I thought since you are not manufacturing the inventory and such related capital and production would be lower?
- Siddhartha Mundra:** Our legacy store are not necessarily customers interface kind of stores. For a lot of the new product categories that we are introducing, we need to have more customer look and feel in our stores and hence the Capex in the store goes up.
- Rajesh Kothari:** Absolutely, that is Capex, but I am saying in terms of the working capital. I thought the new store would have lesser amount of working capital?
- Siddhartha Mundra:** Yes, that is a fair understanding.
- Moderator:** Thank you. The next question is from Nitin Gosar for Invesco Mutual Fund. Please go ahead.
- Nitin Gosar:** Sir, my first question is trying to understand on the customer profile. Has it changed substantially or if you can help us understand between the two factors like that is the upgraded stores versus the old stores? What is the kind of nature, is it materially different or it continues to come with along with contractors? And what is the kind of quality of spend he does?

- Siddhartha Mundra:** In terms of our upgraded stores, we are seeing a large number of end home owners walking in directly into the stores. A large percentage of times they are actually not accompanied by the influencers or may be carpenters or contractors or whoever.
- Nitin Gosar:** Vis-à-vis the old store, once they are upgraded to the new look and feel, what is the kind of change you are seeing in the walk-ins and the transaction item like value of transaction?
- Siddhartha Mundra:** So the number of walk-ins have actually gone up for the locations where we have upgraded those stores. In terms of the transaction side, we are not seeing a very material difference because most of these purchases continue to happen through the entire period of the house construction or the renovation. So the buying patterns so to say I do not think would have changed substantially. But yes, the people who are buying these products, they tend to see a shift in the upgraded stores in favor of the home owners.
- Nitin Gosar:** So last question pertaining to the way monsoon is going right now. It seems that a couple of states in the southern part are running short on water table or the actual rains that are missing. In past have we seen any kind of substantial orders because of lower monsoon, any sense on how closely dependent this particular territories there on monsoon?
- Sukumar Srinivas:** Yes, generally in House Building, we had not in the past seen any except if there is in excess monsoon very heavily, there is a bit of slowdown in terms of the actual construction that happens in the phase of the monsoon. But let us say that the monsoon is below average this year, I do not see that is having any impact in the consumption post the monsoon season.
- Moderator:** Thank you. Next question is from Saumil Mehta from BNP Paribas Mutual Fund. Please go ahead.
- Saumil Mehta:** A couple of questions from my side; one is if I look at the last 6-7 stores which you have added, it looks like unlike previous thesis of the new store being much larger in size, the area of a store seems to be in line with our average of about 3,200, 3,300. I am trying to understand is there a change in strategy which we are seeing now?
- Sukumar Srinivas:** No, the 3,500 is the average that we are talking about, so we really have not changed that strategy over there.
- Saumil Mehta:** But I believe we were earlier looking to most of the new stores which we are going to open were about the largest stores averaging about 5,500 or may be those kind of area, so I am just trying to guess, will the incremental stores be also similar size what we have today or we plan to open much larger stores?
- Sukumar Srinivas:** We probably are looking at the next quarter when there would be a couple of stores with a larger size but primarily we look at the location as paramount where we open a new store and then as

we are today looking at rental premises or lease owned premises, we give the first importance to the location then followed by broadly the size. Obviously, I cannot have 1,000 sq.ft. kind of a size for a store. But if it fits into our bill of 3,500- 3,000 to 4,000, we are quite comfortable. That model has worked pretty well. So we still would continue with that. Combining with a larger format, it should fit in our other parameters of ideal location, kind of costs and rental.

**Saumil Mehta:** So may be over the next two years, it is a reasonable assumption of the average size of a store going above 4,000, 4,500?

**Sukumar Srinivas:** In a way we have seen success at this particular size, we will be looking at the bigger box of let us say a larger format with either some sort of an experimental fashion. So, we are looking at a fairly substantially larger format, which we will talk about in the next quarter or if the store is ready by this quarter we will definitely make the announcement. So there is some amount of experimentation that is going on. We have got sets which is successful, we would continue to run this 3,500 - 4,000. We do have a store of 6,000-7,000 sq ft which already have picked up revenue and which is doing quite well, we are looking at a slightly larger format. So yes, in a way the premise that you are making that it could go to an average of around 4,000 is definitely correct may be looking at the next one year kind of a perspective.

**Saumil Mehta:** Sir, my second question well in terms of your Retail sales. While we have seen a very strong growth for the last couple of quarters now, do we see incremental growth faster for some of the newer products like lightening or paints or is it the traditional products which we sell in the Retail who have had a higher share and whose growth rates are stable?

**Siddhartha Mundra:** From the new product categories, we are seeing fairly good traction. So that is actually coming true.

**Saumil Mehta:** So is it fair to assume lightening and some of the newer products have shown a much stronger growth in the last 2-3 quarters for us now?

**Sukumar Srinivas:** The Sanitary and Plumbing have shown good thrust which has really shown significant growth. Lighting of course, we started at a low base, so I would say we have grown thousand percent on it, probably, the statistics is a bit overrated in that way. But yes, across the various newer products, we are seeing significant growth. Our older products have also sustained pretty well, it is not that they have degrown or something like that.

**Saumil Mehta:** Over the next 2-3-years, what could be the share of the newer products be in the total portfolio of Retail sales from where we are right now?

**Siddhartha Mundra:** So possibly upwards of around 25% should be an estimate.

**Saumil Mehta:** Where would be we as of now?



- Sukumar Srinivas:** Around 10%.
- Saumil Mehta:** 10% can go to 25% for the new products share.
- Sukumar Srinivas:** Yes.
- Saumil Mehta:** In Q1 FY'18, while we are consciously trying to degrow our Channel business, but if I look at Channel plus Enterprise together, was the decline more of pricing-led or was it more of a volume-led decline for this quarter?
- Siddhartha Mundra:** It was a volume-led decline.
- Moderator:** Thank you. Next question is from Rahul Agarwal from ICICI Prudential Life Insurance. Please go ahead.
- Rahul Agarwal:** How many old format stores are there out of these 112-stores right now?
- Sukumar Srinivas:** 80-odd stores.
- Rahul Agarwal:** So by this year end, we should look at going down to 60?
- Sukumar Srinivas:** Yes.
- Rahul Agarwal:** What kind of investment would that entail?
- Siddhartha Mundra:** Again depends on the specific store, but around, 50-odd lakhs per store is a good number to work with.
- Rahul Agarwal:** I want to understand that previous 7-10 stores have got upgraded, how have they ramped up? When these old format goes to new format, what is that lag period and how does that ramp up happen?
- Siddhartha Mundra:** There is 3-6-months period which these stores take in terms of making their catchment areas or rather to make their customer segments aware of these facts that we are carrying these new product categories and making that available to them. But post that, there should be reasonable cash flow that happens.
- Rahul Agarwal:** Basically, 3-6-months is what we should look at. So this quarter, you have upgraded 10-stores, in Q4, you basically see the big benefit that comes in?
- Management:** Yes.
- Rahul Agarwal:** So what is our Capex guidance for FY'18 and '19?

- Siddhartha Mundra:** We are looking at around Rs.25 crores to Rs.30 crores for FY'18. **Sukumar Srinivas:** This year, we are looking at around Rs.25-30 crores and around Rs.20 crores in '19.
- Rahul Agarwal:** From what I see sir, if you have Rs.50 lakh per store from the old format to new format transition and we are expecting some 30-odd stores in that, so you end up with close to around Rs.15 crores and then you have new stores which you are guiding at around each Rs.30 crores from that as well?
- Sukumar Srinivas:** Yes, it is Rs.20 crores from the new stores and 50 is a ball park figure, there are stores which the upgrades happen at a much lower cost also.
- Rahul Agarwal:** Sir, one thing which we have seen across the Building Materials is that lot of destocking has happened across the dealer levels and everybody. But that is not evident in our numbers. So what was the strategy, how was the competition behaving in this period?
- Sukumar Srinivas:** The destocking really happened in the month of June because of the GST uncertainty, there was this very clear thing that those who did not have an excise, bill in those months wanted to sort of destock and make sure that most of their inventory had either an excise bill or they have brought it from legitimate source. So that is one of the key reasons why there were quite a bit of a destocking that happened particularly in the month of June. For us, it does not really matter significantly because anyway all our bills are billed, everything is bought from a genuine source with an excise gate pass, so we really did not have any impact from the taxation angle and GST. GST by and large coincided with whatever was the excise duty and the VAT that were relevant in the various states. So we looked at a product, let us say like Sanitaryware which is 28%, it had 14.5% plus 14% about 28.5% which was the earlier taxation, that slide at 28% and so on. Steel, it was around 12.5% plus 5% which became to 18% now. So it really did not have an impact on us. So we really did not look at destocking as such significantly in our journey from Q1 to Q2.
- Rahul Agarwal:** But the bigger question is the inventory that you have in place now at the end of June quarter. So, if all that inventory is excise levied, how much credit can we have later in the GST?
- Sukumar Srinivas:** Of course, entire thing is credit. It does not have any impact on the revenue or on the profits.
- Rahul Agarwal:** Can you just give me the figure what is your inventory on June quarter?
- Siddhartha Mundra:** June quarter was Rs,300 crores.
- Rahul Agarwal:** This includes debtors from your own manufacturing and the outsourced one?
- Siddhartha Mundra:** It stands around Rs.306 crores.
- Moderator:** Thank you. The next question is from Sanjay Dam from Old Bridge Capital. Please go ahead.

**Sanjay Dam:** Sir, when you upgrade to the new stores, how you will recover that investment? What is the duration that you see going forward given the ticket size of investment and also the fact that your product profile will also be changing in the next 1 or 2-years vis-à-vis the product profile in your old format stores?

**Siddhartha Mundra:** So the incremental Capex that we do for upgrades, once you start getting traction, within a year of that we should cover the incremental Capex..

**Sanjay Dam:** So basically, you are saying that you expect to recover the capital that you spend behind upgradation in one year's time.

**Sukumar Srinivas:** Yes.

**Sanjay Dam:** Given the way you are seeing the product profile changes at your stores; one is your transitioning from the old stores with the new ones and that will continue for the next three years, and also you are opening new stores. Would it have a very significant impact on the ROC that you have from the current profile that we see sir?

**Siddhartha Mundra:** So we hope that these upgrades will continue to be more capital efficient than what we have already done. Most of these are add-ons to our existing store network and our margins in these newer product categories should be better from our current product categories as well as possibly on the working capital side also. This may be more efficient on the working capital. So that would be a fair understanding, but let us see how that actually pans out.

**Sanjay Dam:** The last question from my side is that if I look at the capital that is invested in Retail, Enterprise and Channel, and if you were to break that into a percentage; out of every Rs.100, what is invested in Retail, Enterprise and Channel? How do you see that at the end of FY'19 because beyond that probably we do not have a very clear granularity? If I were to look at your balance sheet today or rather at the end of FY'17, what is the breakdown of that working capital between Retail Enterprise and Channel, how would that change between FY'17 and '19?

**Sukumar Srinivas:** The challenge of allocating is more on the zig-zag side, the working capital can be allocated.

**Sanjay Dam:** Even your working capital will change a lot because you dramatically will reduce Channel. Enterprise probably will remain fix while Retail will grow quite significantly. So how do you see that changing, if you could give us some ballpark number, I am sure it is not easy answer to give, but some internal calculations you must have done?

**Siddhartha Mundra:** Currently, the Capex on the Retail side would be around 20%. I think that will be double over the next three years in terms of the overall percentages, that is because we also share the warehousing, etc., which accounts for a number. So if we are not to apportion we backed up, it would be around 40%. But I think if I were to apportion that part of warehousing and that part

of my manufacturing, etc., the Processing facilities, part of it will be Retail, I would say overall it would be around 50-50 by that time.

**Sanjay Dam:** Enterprise would be how much, sir?

**Siddhartha Mundra:** Can I just come back to you on this exact detailing on these numbers?

**Sanjay Dam:** No problem, sir, I will write to you separately on that. Given the sense of how the returns on the capital will also pan out over next three years. Finally, is there some seasonality in the gross margins which is there on the revenues, which are there from quarter-to-quarter, because between the fourth quarter of FY'17 and the first quarter of FY'18, there was some 100 bps lower gross margin. So is it that some parts have better gross margin than the other parts by the profile?

**Siddhartha Mundra:** In the Q4, it is the time we have a lot of these volume-driven discounts, etc., which are given by lot of the manufacturers and the buyers and from many of our suppliers. So those numbers other than some of the bigger ones like say JSW which goes into our Processing area, which is accounted generally on a quarterly basis, there are a lot of other sourcing where there was discount structure, i.e., the turnover discounts, etc., are accounted in Q4. So generally Q4 would always tend to be on the gross margins, etc., best quarter.

**Sanjay Dam:** Is there some debt on the books sir?

**Sukumar Srinivas:** We have some debt actually.

**Sanjay Dam:** How do you see the debt profile moving in the next two years?

**Siddhartha Mundra:** Currently, we have capital of around close to Rs.235 crores approximately on the books in the quarter. We are working constantly to improve it; however, for our Processing there is some amount of inventory that builds up primarily in our raw material buying where we do not get a significant credit period. We do get some credit, but it is not adequate. I do see that number coming down, which again I will take upon you one-on-one as on what is the kind of figures that is likely to come.

**Moderator:** Thank you. The next question is from Amit Purohit from Emkay Global. Please go ahead.

**Amit Purohit:** One feedback with regard to the upgradation of stores. So is there any challenges or some of the catchment areas probably have not picked up as per your expectation or almost all of them were in line with your expectation in terms of post-upgradation?

**Sukumar Srinivas:** One of the reasons why we are handling in a way our upgradation is quite cautiously because of the existing location of some of the older stores. So what happens primarily is that we look at the catchment area, because some of the older stores, let us say were located in a semi kind of

industrial area in an outskirts where not much of building activity in terms of housing coming up. So some of that have been going slow. But by and large once we have taken the upgradation, the sales have largely been on expectation, we have done about 20-odd stores in this last one year and I would say barely about two are really not growing as per our expectations.

**Amit Purohit:** Any specific reason, is it largely catchment area issue or there is a competition in that specific area?

**Sukumar Srinivas:** I would say that probably the profiling of the customer there has to be a little better and we probably need to work on the Processing in those specific areas that we are able to take on both the competition as well as sort of get into the real catchment area there.

**Amit Purohit:** On the segmental performance, when I look at the other segment which is excluding the Retail segment, the margins have come off quite a lot and you indicated that the focus clearly is on the customization as far as Enterprise is concerned. So is the margin drop largely because of Channel business and that also because there was GST and to that effect the Channel business had to incur some one-time loss or something?

**Siddhartha Mundra:** That is a fair understanding on account of GST, there were some challenges that we faced.

**Amit Purohit:** In terms of the Retail segment, the margins have gone up quite substantially. Is that to do with only because of the upgradation in the Retail stores and that has been the driver? Is it sustainable or there is some tough one-off in it?

**Siddhartha Mundra:** I think the margins that we had in the last year should be looked at as more sustainable kind of margins. I think there were certain one-offs that happened in this quarter.

**Sukumar Srinivas:** Right now in our internal projections we are looking at in the Retail steady state of around 10-10.5%.

**Amit Purohit:** Sir, when you say 55% was own manufacturing and Enterprise is about Rs.190 crores, that means the entire thing is own manufacturing in Enterprise and there is no outsourcing from a third-party for addressing the demand, is that a fair assumption?

**Siddhartha Mundra:** There is some element of outsourcing that happens there as well.

**Sukumar Srinivas:** It is not very significant.

**Amit Purohit:** On the Capex plan, you indicated Rs.25-30 crores of Capex. Can you break it down because I understand there would be some growth in the Enterprise also, right, because in case you are expanding your Retail footprint, you would require this expansion in the Enterprise also to sustain to ensure that the availability or the entire ex-Capex is towards the Retail?

- Sukumar Srinivas:** It will be a mix actually across the three parts of the business. For FY'18 we will have possibly a larger share which will be going towards our Capex for the Processing facilities, which will come down in FY'19 and Capex for the Retail will continue to trend back to the numbers that we have been saying about Rs.50 lakhs per store.
- Amit Purohit:** That Capex is largely you are saying is working capital, right?
- Siddhartha Mundra:** No, this will be Capex as in the way we understand. Capex which means hard assets in terms of doing of the store and upgrading the store. There will be an addition. Rs.50 lakhs odd of working capital that maybe required for the additional revenues that will come from those stores.
- Amit Purohit:** So just for my understanding, if the existing store Re.1 crore is the cost that you set up, additional about a crore will be added to it to be an upgraded store, is that a fair number or I am getting it wrong in this?
- Siddhartha Mundra:** Capex would happen immediately but the working capital ramp up would happen over a period of time.
- Amit Purohit:** So we have a total Enterprise capacity of about 3 lakhs. So this would increase by how much? Do we have a specific number to this for FY'18?
- Sukumar Srinivas:** I would say the number would go up to around 3.20 lakhs in terms of whatever the kind of production we are looking at. The kind of Capex that would go into the Processing would largely be related to upgrading some of the existing equipments, it is not like a brand new Capex that is coming in to really increase the installed capacity, in a typical sense that we understand., But here we are looking at processes that can be upgraded so that we can press the assets out better, so if I have to invest Rs.10 crores in the Processing, which would yield 10% greater utilization, it is in that line that we are looking at the Capex into processing facilities.
- Moderator:** Thank you. The next question is from Shaleen Kumar from UBS Securities. Please go ahead.
- Shaleen Kumar:** I just want to understand a bit on the Retail segment side. In terms of your traction of your stores, in tier-3 cities versus tier-1 cities, so is there a material difference between the same-store sales growth you see over there?
- Siddhartha Mundra:** There would be better sales from the tier-3 cities. We would have possibly a higher share of same-store sales growth than in a tier-1.
- Shaleen Kumar:** Our growth guidance of 15-20 stores addition per year, so roughly what kind of breakup will it be between these Tier-1, Tier-2, Tier-3 cities, how we are going to go ahead with that?
- Siddhartha Mundra:** We are looking at more or less similar kind of share across all the three tiers.

- Shaleen Kumar:** Should not be like we go higher in the tier-3 given we are seeing higher traction and I am presuming your rentals will be lower over there?
- Sukumar Srinivas:** We are very bullish on the Tier-3. I am giving a very broad number, we are saying that today of about 38-40% of our Retail revenue comes from the Tier-3 and about 30% from the Tier-1. So, we have taken it up from around 30%-odd last year to around 40% in the Tier-3. So yes, we are a little more bullish on the Tier-3 certainly. But having said that, tomorrow if there is let us say a rapid growth in a city like Chennai or Hyderabad, which would really come into line of metro, because today we do not have a significant presence let us say in Chennai which will be very-very important for us to see to take forward the next level of growth in a state like Tamil Nadu which is a big state for us. So in that sense, when you would see suddenly a blip in Tier-1 which would come in for a short period of time and then again probably plateau up.
- Shaleen Kumar:** On the similar lines, given that we are having a good traction in Tier-3, is it because of the low competition in those cities or is it because you are able to add value in those cities and in Tier-1 cities we have higher competition, not much scope to add value or product mix?
- Sukumar Srinivas:** I think we are adding value. The competition in this country is there in any area, any field, you go anywhere, there is somebody or the other doing whatever kind of business whether it is building product or a food product or whatever, we are a competitive economy. So we have mentally taken that for granted. I think we significantly value in terms of offering the entire products under one roof, there is reliability and trust factor. So I think these are the real offerings that the company is continuously giving to the customer. I think that is what is giving us the traction.
- Moderator:** Thank you. The next question is from the line of Maulik Patel from Equirus Securities. Please go ahead.
- Maulik Patel:** What could be the margin for the Processing in this quarter?
- Siddhartha Mundra:** Around 6%.
- Maulik Patel:** Correspondingly for Q1 FY'17?
- Siddhartha Mundra:** Roughly around 6.5%.
- Maulik Patel:** In Processing, how much of the capacity addition we are looking at within this year because we are closing I think around 3,40,000 tons was our capacity?
- Sukumar Srinivas:** We are utilizing about 90%-odd of that capacity. Like I mentioned earlier, we are not really adding capacity in terms of fresh Capex, but we are only looking at improving certain Processing

facilities to improve the sweating the current assets. So if I can pull out instead of 325, if I can take it out to 350, that would be the kind of numbers that we will be looking at.

**Moderator:** Thank you. The next question is from the line of Kamlesh Kotak from Asian Market Securities. Please go ahead.

**Kamlesh Kotak:** Sir, just wanted to understand about the brand. How much brands do we have tie up currently and is there a long-term tie up with a brand or how it works?

**Siddhartha Mundra:** We currently have over 100 brands through our Retail stores. We look to work closely with them, we look to have alignment with them through our Retail stores. We have interactions with their product experts in our Retail outlets for us to first understand their product as well as to ensure that our customers also understand the various benefits that these brands carry. So it is a fairly kind of strong relationship that we would like to build with all these brands.

**Kamlesh Kotak:** What is your target to increase the number of brands over the next two-three years maybe?

**Siddhartha Mundra:** I do not think there is any target as such but we are looking to consolidate in these five broad categories that we have identified for ourselves and to ensure any major product offerings that should be in these categories are getting categories addressed.

**Kamlesh Kotak:** Just to put it otherwise, how many brands we have added last year compared to the year before?

**Sukumar Srinivas:** I think probably in FY'16 we are looking at about 25-30 brands, we have crossed 100 mark in the last quarter.

**Kamlesh Kotak:** Sir, as you mentioned of course, we are offering the value proposition. Also, we are having some price advantage vis-à-vis competition in terms of the customers catering and being a large format store like. So is it also one of the value proposition part of a strategy?

**Sukumar Srinivas:** One of the reasons when we say that we will not randomly add brand, we will also look at consolidation because like you have rightly pointed out that once we start consolidation, give the volumes to the brand, there is an obvious price kicker that starts coming in which is favorable to us. So because of the diversity of the Indian markets, diversity of the Retail sales, there are large number of brands that operate any product category which we take it on based on the regions and then we would like to consolidate and see that the margin kicker is best for the company.

**Kamlesh Kotak:** Any long-term plans we have in terms of going into non-south states?

**Sukumar Srinivas:** I think in medium-term of 2-2.5 years at best we will definitely be focusing on the south, and after that, certainly we would be looking at states like in the western region and so on.



**Kamlesh Kotak:** When you say the stores upgrade, is it also having a change in location in terms of the criteria like moving from industrial to a better catchment area, is it also one of the factors you consider?

**Sukumar Srinivas:** Yes, we do consider that. I think currently it is happening out of our existing stores; in about two stores where nearby we are looking to shift the location because like you rightly mentioned the catchment area would be more fruitful.

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

**Jaspreet Singh Arora:** Just a clarification; this Capex that you mentioned on new store versus upgradation, it is same at Rs.50 lakhs ex-working capital assuming there is no change of location?

**Sukumar Srinivas:** The upgradation would be less; we have been paying Rs.50 lakhs to Re.1 crore. We have always been adding that the working capital component that comes in terms of the new products that come in. So yes, the upgradation for the old stores would certainly be less than what is the cost that is incurred for a primary store and you should take it broadly without taking the current asset part of it in the inventory.

**Jaspreet Singh Arora:** Sorry, you mentioned on the Retail margins being one-off there to reach at+11%. So why cannot we maintain those 11% margins?

**Sukumar Srinivas:** We are working towards a 11% margin and more if possible, but probably we would like to be a little cautious also in guidance number.

**Jaspreet Singh Arora:** On GST, last 40-days which has been there since implementation, any positives or negatives that you witnessed, any takeaway that you would share in terms of the movement across your warehouses to the stores and also in terms of any input tax credits that you have got, anything you would share?

**Sukumar Srinivas:** One thing of course, the first two weeks of July there was a lot of confusion in the market, so we were confused in terms of the rates and there was a lot of the other kind of stores and competitors particularly, people continue to do the billing at the old rates with the VAT and so on, particularly when you look at some of the influence of purchases, there was even more confusion with GST and the service tax replacement. But I think that has pretty much settled down now. The only impact that I see in the GST is, earlier whenever you had product in your revenue, you were always considering the excise component that formed a part of the revenue when you purchased a particular good and it was only the VAT which came out of your top line of your revenue. Now, what we see is that the entire 18% of the GST is out of your revenues.

**Jaspreet Singh Arora:** So your margins may look better. Is this what you mean assuming your absolute profit being the same?

**Sukumar Srinivas:** Profit, there will be no impact at all. So there would be some amount of an impact in the revenue because earlier when I had bought out an item in the Retail, you always had the turnover which included the excise component or whatever be the product, let us say, in a tile it was 14.5% or in the steel products it was 12.5%, whatever the excise duty came in as part of my cost as well as my revenue when I sold, it was always the VAT that was kept out. However, now the entire 18% or 28% of a particular product would be kept aside as a tax. I would be taking it as a credit and I would be paying it off and when I sell it I do not take that as part of my top line revenue. And if I were to give a guidance of this quarter and say that we would do let us say 600 or 700 crores, that means compared to the pre-GST I would actually be doing 12.5% more in terms of my top line growth. Probably I can explain the math a little more to you one-on-one but yes, I think across the board as a reseller, as a trader in whichever form you look at it, there would be some amount of struggle to retain the top line growth.

**Jaspreet Singh Arora:** In nutshell, you are saying the top line may reduce a bit but the margin may improve while absolute profit may remain the same, is this what you are saying?

**Sukumar Srinivas:** No, in our case I am not saying the top line would reduce, we are certainly not going to have a reduction in the top line, but as you ask me what is the kind of an impact GST could have, these are the kinds of impact from a theoretical perspective that GST could have an impact.

**Jaspreet Singh Arora:** Since you are present in Tamil Nadu, we have heard there has been slowdown in the construction industry specially when it comes to sand aggregates and cement, so our percentage share is pretty less, but anything you could share over there?

**Sukumar Srinivas:** I will tell you the real reason for what happened in Tamil Nadu. Virtually over the last 8-9-months or nearly in a year till about a month ago, the government has brought some sort of restriction in registration itself. In registration of property there was a lot of confusion and post-Jayalalithaa there was a lot of confusion as to what was to be done and I think till June they virtually stop registering properties, luckily in the last month, they have removed that particular restriction as they are back to in terms of registering property. So there was a slowdown, there was a sort of a dampening of spirit saying that no new properties were being registered, so that has gone now. So I see that as a positive. Sand is an issue that has been happening across various states over the last many years where the governments took over the dealing of sand, centralized sand purchase and so on. But I think that has also gone away now to a large extent because most of the states have centralized sand, Tamil Nadu was one of the first states to do that. Now the other positive thing in sand is, there is a lot of manufactured sand that is finding its way. So I think that has also helped in easing the availability of sand. So I do not really see that as a significant dampener on construction going forward.

**Jaspreet Singh Arora:** So do you track the SSG on a state-wise basis, just to understand the state impact better? Would Tamil Nadu have a flat to negative SSG?

**Sukumar Srinivas:** Yes, absolutely, we have to track the dynamics of every state because a lot of the subjects that we talk about are state-specific. One good thing is both GST as standardization on taxation across all the states, certainly one kind of an unknown has gone out of our perspective in one way but yes, there are a lot of state-dynamics that one has to track.

**Moderator:** Thank you. The next question is from Prithvi Raj from Unifi Capital. Please go ahead.

**Prithvi Raj:** On Channel sales, we are on a consolidation phase now. So do we have any timeline on when do you expect this to be completely phased out?

**Sukumar Srinivas:** The consolidation phase as far as the Channel part of the business will take another couple of years before like we have mentioned earlier that currently from around 25 come down to about 22, probably year-end targets are moving into the late-teens and by around 2020 we are looking at taking it to the late single digit. So that we have got a very clear focus as far as that phase of the consolidation happens. However, having said that, that is one part of the consolidation. But as far as the Retail perspective, certainly, we are not on any consolidatory phase, we are looking at ramping up and keeping our (+20%) growth very much alive.

**Prithvi Raj:** How are the margins in the Channel sir for this quarter?

**Management:** Aggregate Channel and Enterprise we have margin of around just under 6%.

**Prithvi Raj:** Do we have any further breakup between Channel and Enterprise?

**Management:** We do not have any breakup.

**Moderator:** Thank you. The next question is from Rahul Agarwal from ICICI Prudential Life Insurance. Please go ahead.

**Rahul Agarwal:** One question on this competition thing. So we have got a lot of unorganized in our sector. So how has this unorganized guys transition to GST?

**Sukumar Srinivas:** I think we are finding it difficult. I think the first two weeks of July saw them shell-shocked. As any good Indian businessman, they will recoup and recover. But I do see that GST having a very-very positive impact for the organized sector.

**Rahul Agarwal:** So do you think there could be some kind of consolidation at some level, I know it is very small at this point in time, but do you think that can happen and you may look at some other guys who are near the catchment areas?

**Sukumar Srinivas:** Yes, we could.

**Moderator:** Thank you. The next question is from Mehul Desai from IDFC Securities. Please go ahead.

- Bharath:** Hi, this is Bharath here. Just on the GST side on the Channel degrowth, how much of this in the quarter would you attribute to your own initiatives to cut down and how much is possibly would be from destocking from GST impact Retailers who are buying the way they want?
- Sukumar Srinivas:** I think it is our entire initiative. We really did not consider GST as part of a measure to degrow the Channel business. So I think it is a very conscious degrowth decision.
- Bharath:** Again on GST, was that you have spoken about the supply side, etc., but I just wanted to get a sense of whether there was any consumer demand towards June and July as these months being a bit subdued, for example, contractors or interior guys or consumers or end consumers who are probably just waiting before the price changes kind of took effect if any. So was there a feeling in terms of footfalls that maynot be as robust as it would have been as even the end consumer was probably waiting it out?
- Sukumar Srinivas:** I think there was let us say trepidation in the end of June because one thing there was still this sort of hope with a lot of people that ultimately the government would not enforce GST from July 1<sup>st</sup> and the date could be further pushed because there are a lot of rumors still almost the end moment. In the first half of July from the contractors and the influencer purchase, because there was some lack of understanding as to what is the kind of from the service tax regime to GST regime what is the kind of changes, there are a lot of confusion. Yes, overall, June was a little subdued and I would say the first couple of weeks in July have also been subdued. But I think post that we have seen largely I would say business is as usual.
- Bharath:** Is it fair to assume that you could see some level especially before the festive season kicks in, some level of possibility with the four weeks of pent up demand which could start to come in August and September, is that something which is a likely scenario going forward?
- Sukumar Srinivas:** We would really like to think so because the other reason in the building material industry in this Ashad months which largely comes in let us say the whole of July and in some parts of the country till about 10<sup>th</sup> of August and so on. The building materials industry, people do not start new construction, a lot of the new things do not happen. So there is generally a slowdown in that period, of course, which also depends on the kind of rains that happen in various parts of the country and the festive season is normally the robust period when people start looking at starting something new. So we would hope that there would be an uptick in the festive season.
- Bharath:** What would have been the debt net level or gross level whatever you have at the end of the quarter?
- Siddhartha Mundra:** Around Rs.220-odd crores.
- Bharath:** This would seasonally now move up probably in Q2 as we stock more on the Enterprise and Channel front?

- Sukumar Srinivas:** There could be a marginal upward movement, but nothing significant.
- Moderator:** Thank you. The next question is from Rahil Jasani from ICICI Securities. Please go ahead.
- Rahil Jasani:** On Retail stores, so what is the store churn, how many stores are you closing and opening?
- Sukumar Srinivas:** There are no closures at all.
- Rahil Jasani:** Are these stores company owned, company operated on the co-co model or are there any franchise model that you are looking at right now or even in the future probably for your growth prospects?
- Sukumar Srinivas:** No, right now certainly not, we are all in leases rental model.
- Rahil Jasani:** As in you said that in the upgraded stores, you are seeing many home owners which are not accompanied by consultants or architects, so there are many walk-in home owners which are buying your products and there is demand from them and there has been a lot of buzz in the online space also, Amazon has started advertising on building products, they are going very big on it. So are there any plans to tie up with these online players or probably increase your online footprint in any other way?
- Sukumar Srinivas:** No, online is something that we are also considering. So let us see.
- Moderator:** Thank you. Ladies and gentlemen, that was the last question due to time constraints. I now hand the conference over to the management for closing comments. Over to you.
- Siddhartha Mundra:** Thank you everyone for taking the time out and coming for a concall. There was just one question that has come in during the course of this call which was on capital allocation between Retail and our other segments. So I just want to quickly take that up. While it is difficult to kind of broadly allocate capital, I think a good thumb rule would be that currently around 25-30% of our overall capital would be deployed in the Retail part of the business. So as the share of Retail increases, this percentage should increase further. I hope that is a reasonable guidance in terms of understanding capital efficiency of our business. So thank you everyone once again, thank you for taking the time, it was a pleasure talking to all of you.
- Sukumar Srinivas:** Thank you so much.
- Moderator:** Thank you very much, members of the management. Ladies and gentlemen, on behalf of Shankara Building Products Limited, that concludes today's conference call. Thank you all for joining us and you may now disconnect your lines.