August 16, 2023

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

Scrip Code: 539450

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

Scrip Symbol: SHK

Dear Sir/ Madam,

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

Pursuant to Regulation 30 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, we are enclosing the transcript of Q1 FY 24 Earnings conference call for investors and analysts organized by the Company on Tuesday, August 08, 2023 at 12:00 Noon IST. The audio recording and transcript is also available on the website of the Company.

You are requested to take the same on record.

Thanking you,

Yours faithfully,

For **S H Kelkar and Company Limited**

ROHIT SARAOGI
Digitally signed by ROHIT SARAOGI
Date: 2023.08.16 14:33:35 +05'30'

Rohit Saraogi
Company Secretary & Compliance Officer
Encl: As above

S H Kelkar and Company Limited
Q1 FY24 Earnings Conference Call Transcript
August 08, 2023

Moderator: Ladies and gentlemen, good day and welcome to the SH Kelkar & Company Limited's Earnings Conference Call.

As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Mit Shah from CDR India. Thank you and over to you, Mr. Shah.

Mit Shah: Thank you. Good afternoon, everyone and thank you for joining us on SH Kelkar & Company Limited's Q1 FY24 Earnings Conference Call.

We have with us Mr. Kedar Vaze - Wholetime Director & Group CEO and Mr. Rohit Saraogi - EVP Group CFO & CS of the Company. We will begin the call with brief opening remarks from the management, following which we will open the forum for an interactive Q&A session.

Before we begin, I would like to point out that certain statements made in today's call maybe forward-looking in nature and a disclaimer to this effect has been included in the earnings presentation shared with you earlier.

I would like to invite Mr. Kedar Vaze to make his opening remarks. Thank you and over to you, sir.

Kedar Vaze: Thank you. Good afternoon, everyone and thank you for joining us on our Earnings Conference Call today. I hope you have gone through our "Results Documents," which were uploaded on the exchanges earlier.

We have commenced the Financial Year 2024 on a promising note, delivering a steady growth of 7.7% from operations in the first quarter. Notably, our operations in the Indian market showcased a healthy growth of 12.1%. This performance was supported by traction from a large customer and comparatively lower base in the previous year.

Meanwhile, growth in Europe stood at 3% on a constant currency basis in spite of all the challenges in the region. Our focus in Europe will be to optimize plant capacity utilization and drive profitability through better mix and margin. Our Core Fragrance division delivered growth in profitability, driven by upward price adjustments. Similarly, the European segment displayed improvements in margin, particularly given last year's challenges, the margins were significantly affected by escalating costs. On a consolidated basis, our operating EBITDA grew by 33.4% year-on-year, reaching Rs. 73.5 crore. This reflects a margin of 16.5% on sales.

Our Flavour division faced a mild downturn mainly due to softer demand from international markets. At this time, we are in the process of building the capability and infrastructure to meet the next level global standards in Food and Nutrition space, enabling us to cater to larger global customers.

Moving on to the update on the Global Ingredient segment, we have entered into an agreement with the third-party vendor to support our backward integration effort. We anticipate that we will be fully backward integrated from Q4 onwards and reduce our dependence on China.

As many of you might recall, last year we were honored to be invited to bid on RFP by a large global FMCG player. This invitation serves as a testament to our position as the largest Indian origin Fragrance-Flavour company with a presence in key global markets. Since then, our teams have consistently worked on various briefs issued by this company. This collaboration has taken much more time than initially anticipated. Even with these delays, we remain positive about the huge growth potential this partnership promises in the future.

Despite various external challenges that have impacted our growth in recent years, we remain firm in our commitment to expand and enhance our global operations. This growth-oriented focus is underpinned by our global reach, solid client base and robust cash flow position. With the expected volume growth returning to our underlying FMCG sector, we anticipate that our performance would sustain on these levels going forward.

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

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Bharat Gupta from Fair Value Capital. Please go ahead.

Bharat Gupta: Couple of questions from my side. First in understanding the recovery in the gross margins. So, primarily just to get a sense, is it driven largely on account of ease of in the RM prices on account of excess supply in China?

Kedar Vaze: No, we are looking at a gross margin improvement based on our pricing strategy and dialogue with the customers. There are signs of some raw material easing in the current marketplace, but these are very early days and we do not want to extrapolate this for longer term trend. Some raw materials are available at a lower price, but it may not sustain at these levels. So, we are not catching this trend for a longer or sort of a full year period. But yes, tactically we will take advantage of some raw materials being at a lower cost.

Bharat Gupta: And primarily, if I look, should going forward like do we have to pass it across to the end customers and then possibly there will be some pressure coming on the margins as such?

Kedar Vaze: I do not believe there is pressure on the margins from the marketplace. At the moment as you would recall, we had substantial cost inflation in the last 18 months. So, this cooling off is only sort of restoring some of the normal levels of margin where it is a sustainable business.

Bharat Gupta: We currently import around 25% of our requirements coming out from China. So, like, how do you read the scenario? Because like what we are hearing from the Specialty Chemical companies as well as from the other companies, so there has been good amount of overproduction which is due to incremental capacity, which has been coming out from China. So, and given out the way we are thinking like in terms of Global Ingredient supply chain where our performance has remained weak and we are thinking of backward integrating it. So, do you not think that can backfire in terms of our strategy, going forward?

Kedar Vaze: No, I think, if you look at the typical China story, there are years when they are almost at cost or even selling sometimes below cost and then another year they will be taking opportunity of monopolistic sort of market position. So, China as a geography or supply is not stable in terms of their pricing and contractual obligation. So, it is better to have your own value chain which is completely backwardly integrated within the domestic supply chain. What we also see is that our domestic supply chain and our technology is sufficiently capable to meet the cost challenges of Chinese competition. So, we are able to produce, I believe that post the end of the year, we will continue to remain the lowest cost producers for some of the Global Ingredients that we make.

Bharat Gupta: Also post the integration, our RM exposure from China that will continue to remain above 25% odd levels or we think of coming it or reducing it going forward?

Kedar Vaze: It will substantially reduce post the backward integration and maybe by 5% or 7% further.

Bharat Gupta: So, it can be below 20% kind of a level going forward?

Kedar Vaze: Yes.

Bharat Gupta: Coming on the RFP side, so what is the progress primarily in regard with the RFP sign with the MNC? You highlighted there has been some sort of a delay. But when are we expected to start booking revenues and what will be the margin profile in the segment?

Kedar Vaze: So, the revenues margin segment will be on the lower side in terms of the gross margin. On the operating margin, it will be similar to our current business. If the volume expectations are different, we have a large volume business typically at a lower gross margin, but the same net margins. In terms of the business, I think we have gone through one cycle of product development and submissions, the results came out in July. And there has been a change in the company's strategy and expectations from the marketplace. And accordingly, they have briefed all the companies for a redesign which is expected to close in the next two to three months.

Bharat Gupta: So, are we anticipating any sort of revenues coming in for this year itself, for H2 FY24?

Kedar Vaze: It depends on when they commercialize the products. So, typically we expect to have some win and kind of commercial orders by end of this calendar. When it gets actually commercialized will depend on the demand and volume and their stock position and contracts with their current suppliers. So, expected that we will win some businesses by end of this year. The exact commercialization in quarter four, or in first quarter next year, while some of the trial commercialization may also happen in quarter three of this financial year. So, it is all up for grabs. In the next 2 months, we will know where the design stands and where are the submissions.

Bharat Gupta: Right. Also, in terms of the industry dynamics, so like apart from the contract which we have signed with the MNC, so are we in process of bidding or working with any other MNCs apart from it for the domestic and the international requirements, currently?

Kedar Vaze: Yes, we are working with multiple MNCs.

Bharat Gupta: Right. Coming on the margin side, so in our Europe business, we have seen a sharp improvement in the margin. So, is it primarily catering to the change in the product mix? And do we expect the kind of margins which we have been able to showcase in Q1 FY24? So, that will be sustainable going forward? Also, you highlighted that our focus continues to remain on the improvement in the utilization levels. So, what are the current utilization levels and like in the regions where we operate in the European markets. So, what kind of a market share do we possess?

Kedar Vaze: So, in Europe, we are basically looking at quite a small market share as a total market. But within Italy in the smaller market, we have a fairly large double digit market share. We are looking at in terms of gross margin, yes, the trend on European business on gross margin will continue. The trend on the gross margin will continue, so parallelly the same cost structure should remain. Our objective is that we are more than 85% in terms of capacity utilization in our European operations, and we are looking at trying to maximize revenue on the volumes that we have to keep the high margin businesses. So, we will see margin improvement as we go forward. And we will look also to use our Indian capacity to service some of the clients from the European zone.

Bharat Gupta: Are we looking at any sort of expansion out there in the European subsidiary?

Kedar Vaze: At the moment, no.

Bharat Gupta: But given 85% is, I think 90% is the saturation level for anything to work out. So, going forward…

Kedar Vaze: Yes. But we have capacity in India. So, we are working out modalities how we can utilize their capacity in India and service some larger clients in Europe. End of the year, our capacity in Indonesia will also be on stream. So, we will then use the additional capacity in India for further expansion in Europe and Middle East.

Bharat Gupta: On a blended basis, what will be the utilization levels across Indian, like you mentioned, European is operating at 85% levels. Across India, what would be on a blended basis utilization level?

Kedar Vaze: India utilization levels are very low, 45% for Fragrance and Flavours. Except the Ingredient business, everything else we have quite sufficient headroom for growth.

Bharat Gupta: But we will be able to match the cost standards which are there like even if you operate from the Indian subsidiary.

Kedar Vaze: Yes. There is no challenge on the quality and standards. The challenge will be managing the logistics and supply chain because in Europe, we will have a four-week lead time. So, to that extent the cost versus the working capital, additional working capital all that we were planning, and we will trial based on few larger businesses on this front.

Bharat Gupta: Right. And like in terms of margins only 23% which we have been able to do in Q1 FY24 in European. So, that is sustainable. But on a blended basis, if I look for the consol entity, what kind of guidance do you want to give with regard to FY24 and going beyond FY25 as well?

Kedar Vaze: So, I think this quarter has been steady business and we hope that if there are no new macro challenges, we will be on a similar platform quarter-on-quarter going forward.

Bharat Gupta: So, we expect that our margin profile to remain stable above 16% odd levels?

Kedar Vaze: Yes.

Bharat Gupta : And our topline growth which we are anticipating for this year. So, that will be remaining in double digit only?

Kedar Vaze: Yes.

Bharat Gupta: Just a question on this, because we have seen that growth primarily has remained muted after the implementation of GST and there were some uncertainties which was coming out from Chinese angle. So, we have diversified across Flavours and doing custom manufacturing also for clients. So, taking into account that inflationary pressures on the RM side are behind and how do you see the company to evolve in the next three to four years and is there any kind of a revenue and profitability target which we have set ourselves for the next three years?

Kedar Vaze: So, we are in the process of reviewing our next three-to-five-year plan. I think the main challenge is while immediately tactically the raw material situation seems to have eased out, I think that these are typical pendulum swings in that if the cost go or the prices in the market go below certain thresholds, certain capacities will go upstream and then there will be shortage and prices will go again in a scenario which has been in the past few years. So, it is not fair to look at this current scenario and say that this is stable pricing, and we will be able to look at a three-to-five-year horizon on the same basis. But at this point we can see raw material pricing not being a challenge and we can focus on growth avenues which we have been sort of differing in the past and addressing new markets, new customer briefs which we were reluctant to take given the raw material situation.

Bharat Gupta: But given out the capacities which we have currently and primarily some are underutilized as well.

Kedar Vaze: So, there is a capacity and there is also a raw material challenge. So, when we had a raw material challenge, we were not aggressive to take in new volumes because we already were finding it difficult to service our current client base with the cost structures. So, now that the cost escalation has stopped and there is a visibility on, stability on some of the raw materials, we will look at more aggressive marketing to gain volume share.

Bharat Gupta: Right, this is what I was coming to because if I look from three-year point of view, the growth which was earlier missing. So, that finally should be factoring in and also we are working with some of the MNCs along with some Indian players also in regard to the product development stage also. So, once the recovery happens in the rural and the urban markets, in the domestic space and the good recovery is happening across European. So, going forward, the 20% kind of a CAGR, which should be there in the overall revenue scheme of things. So, are we on track and we think on similar lines, or you think there can be good amount of challenge or there will be some amount of risk taking that projection into account?

Kedar Vaze: No, I think, let us understand that this business is not one product which sells across the country, it is tailor made for each customer and each region. So, we will continue to grow good double digit and if markets are growing well, then it can be a higher double-digit growth. But binding in place that certain businesses on the ingredient where we have almost 70%-80% global market share, there is not much headroom to grow. So, part of our business which is cash cow or stable where the market is saturated or not growing, we will be unable to grow, that is the dynamics of the market. So, I think the overall for the formulations and new markets, e 20% ambition is there, which should translate to low or kind of mid double-digit growth in the next three to five years.

Bharat Gupta: Right. This is the last question from my side in regard to the gross debt which is there, I think it is pertaining to Rs. 583 odd crore and it has increased from March 23 levels. So, what are the plans for reducing it over the coming years?

Kedar Vaze: Yes, I think this jump from March is largely on account of two quarters of high sales. So, the working capital in the receivables has gone up and that will play out as we are in this new level of sales, it will take 2-3 months of collection time and in the second quarter it should start to be streamlined. But I think our focus is to ensure growth. A lot of our inventory buildup has happened for the tidying over the difficult situation. Now that we see prices coming down, we are also looking at opportunistic and acquiring some of the stock available at low cost. And then, we are looking at a high aggressive volume growth strategy in the remaining part of the year. The working capital as a result has gone up, but our sales will start kicking in and the ratio of working capital to sales days will be in normal around 130 days in the coming quarters.

Bharat Gupta: But any plans for like in terms of whatever free cash flow which you will be generating? So, any plans for reducing the current level of debts which are there in the books?

Kedar Vaze: So, I think the free cash flow will reduce the debt in relation to what we are looking at an aggressive growth. So, if I add Rs.100 crore of extra business, I will definitely need Rs. 40-50 crore of working capital for that growth. So, I do not want to give a number of net debt because if we grow aggressively as what is our strategy in tactically in next 2-3 quarters, we will need to continue to keep the working capital cycle until the cycle stabilizes, we will have to keep the debt on our books. But as a ratio of our sales and as a kind of days of sales, the numbers will come down. The absolute number, we have acquisitions, and we have payouts in the coming quarter from dividend and acquisition payout. So, there will be non-operating cash flow expenses which will keep the debt level at a higher level, but in terms of operations, we will make free cash flow.

Moderator: Thank you. The next question is from the line of Chintan Chheda from Quest Investment Advisors. Please go ahead.

Chintan Chheda: Sir, my first question is related to volume growth. So, can you just share the volume growth in the Fragrance as well as the Flavours division?

Kedar Vaze: So, both Fragrance and Flavours, so Flavours, the volume growth has been zero in this quarter, quarter-on-quarter. And on the Fragrance, it has been 6%.

Chintan Chheda: So, Flavours this is even in India volume is flat?

Kedar Vaze: No, India volume has grown, export volume has declined. But that is again seasonality, I think the export business does not work quarter-on-quarter or month-on-month. There are pickups and kind of stock in the market and then destocking, then again stocking. So, we see this trend over multi years that one or two quarters there is a very strong demand and one or two quarters there will be big demand. So, there is always this up and down in the export markets.

Chintan Chheda: Correct. So, is that the reason why we have seen a sharp fall in the export market revenue for your Flavours division?

Kedar Vaze: Yes, in this quarter, the export revenue has been lower. Last quarter, if you look at it, we had a very strong Flavour export quarter. So, in terms of moving average, it is working well.

Chintan Chheda: So, on a full year basis, how should we look at our Flavours division revenue for India as well as for the rest of the world markets?

Kedar Vaze: I think the underlying CAGR of 12% to 14% we are looking at in the full year and accordingly we will track the business. As I mentioned in my opening remarks, we are now engaging with very large global MNCs in the food industry as well. We are investing to upgrade our facilities to global standards for nutrition and baby care and Pharma applications, where the requirements for the factory are more strict than normal food industry. So, these upgradations will happen in the course of this year and then we will open an additional avenue of growth for the Flavour business. I say Flavour, we need to expand it to Flavour and Food Industry because there are other products in that range in terms of Nutrition and Flavour and Taste Additives.

Chintan Chheda: And Sir, this quarter we have reported one tender fee cost of Rs. 2.63 crore. So, can you just throw some light whether we have received this tender or size of this tender, can you throw some more light on this?

Kedar Vaze: This is the same RFQ which we have been talking about. There's nothing new. We are just accounting for it since it is being kind of expensed out over a period of time. It is reflecting in every quarter year on till the cost of that is borne.

Rohit Saraogi: In this year only.

Chintan Chheda: So, now when can we expect this RFQ?

Kedar Vaze: RFQ work is already ongoing. So, from the timing of the RFQ, commercialization should happen in this financial year. So, accordingly, we have started to take the expenses and we expect the commercial orders in either fourth quarter this year or first quarter next year. So, as per the original RFQ, the first year was design. Second year which is starting now, we should be able to get some commercial wins. So, second, third and fourth year, we will have the commercial wins and accordingly, the expenses for this project have been made as advances in the previous year and they are taken as expenses in this year onwards.

Chintan Chheda: Got it. And Sir, lastly on the global ingredients business side, right, so last year also we had some challenges over here because of say dependence on China or RM shortages. So, how are we seeing this business evolving over the next two to three years and when can we expect breakeven over here?

Kedar Vaze: So, I think if you see last year same quarter, we had a minus 6 EBITDA, this year we have a minus 3 EBITDA. We are very close to breaking even in the second half of this year and once we are fully backward integrated, our position on the global ingredient will be substantially better.

Moderator: Thank you. The next question is from the line of Viraj Kacharia from SiMPL. Please go ahead.

Viraj Kacharia: Sir, just couple of questions. Just continuing on the Global Ingredient business now, if you look at our own initiative on this particular business, I think 6-7 years back we undertook a major CAPEX plan and the idea was to have some captive sourcing and also cater to globally. So, how much of the current business would be captive requirement and how much would be third party?

Kedar Vaze: So, what we are reporting on our results is only third-party sales.

Viraj Kacharia: According to the overall utilization, how much?

Kedar Vaze: Overall utilization about 10% of the Global Ingredient is used in house.

Viraj Kacharia: And just few quarters back, we were looking at the alternative structure for this business given how the changes in supply dynamics especially from China and our expectation of this business on a steady state is low single margin, low ROE kind of, and then we talked about looking at alternative structure or disposing it off. So, what changes in terms of the thought process in terms of doing further investment and having a backward integration?

Kedar Vaze: So, we have not invested anything further. We were looking at exploring our joint venture or any kind of strategic alliance. We were able to close on a sort of a tolling model where we have provided the technology and we are getting the backward integrated product manufactured to our specs on kind of a tolling arrangement with the third party. So, there is no CAPEX from our side or no large CAPEX, there are small storages and things like this which we need to do, but other than that, there is no large CAPEX from our side for the backward integration. It is all done at the vendor's end. The idea here was to explore what is the best method. We found a very good solution with the strategic supplier which we have tied up with. So, we are continuing the business as is.

Viraj Kacharia: And just to follow up on this, once this initiative is largely done by, what is the kind of margin return we can expect from this business on a steady state, I mean the supply factor, say from China, those will always be there. So, on a steady state, how should one look at this particular segment for us?

Kedar Vaze: I think the inherent sort of, strategically, this business is a 10% EBITDA business, and we should be reaching those levels once they pull backward integration and our volume strategy is in place. We are quite confident to be able to reach those levels as we go forward.

Viraj Kacharia: What is the capital employed in the segment after backward integration and later initiatives?

Kedar Vaze: So, there is Rs. 120 crore of fixed asset in terms of this business.

Viraj Kacharia: Second question is largely in terms of the RoW market, so if you look at, the business was kind of impacted related to COVID and supply chain issues. How should one really understand the RoW, especially the Indonesian market because we always talked about the 3I strategy. So, Italy still is doing good; India, you talked about double digit growth, but in terms of the RoW or especially the Indonesian market, how should one understand the scale up and our play there?

Kedar Vaze: So, I think the Indonesia market especially during the pandemic, we had a very clear communication with many of our larger clients that they need local supply chain because there were disruptions in the logistics and container availability etc. So, we had decided earlier, and we've executed this year to put our factory in Indonesia. Given the current dynamics, I think globally there has been consolidation in the industry, further consolidation with Firmenich having merged with DSM whereby we see opportunity of tying up with the larger clients which otherwise were quite close or close relations with the larger companies like the Big 3 or 4 companies. They are now much more open to have second level of suppliers as we talked about large global MNC. Other large companies are also engaging with us. Most of these engagements are fruiting into business, and that business growth will multiply kind of compound as we go forward, but their preconditions to the business is to have local supply chain. With our Indonesia factory, we will open another kind of larger clients in that region which currently are not engaging with us on a full basis. So, our growth will continue to be faster in the coming years.

Viraj Kacharia: So, the question was that I understand that we are looking to set up additional facility in Indonesia, but for the rest of the business, which we're looking to get from large MNCs would the sourcing largely happen from India given the kind of underutilization you have?

Kedar Vaze: It depends on where the product needs to be supplied. So, if it's a Southeast Asia product, we will supply from Indonesia. If it's India Middle East, we will supply from our India operations. If it's Europe or America, we will supply from our European operations. It depends on where is the commercial supply required. I think the advantage for us is that we have surplus capacity in the Indian factories in quick manner, we can scale up capacities. So, that's a big advantage for any customer that wishes to kind of get additional products from us.

Moderator: Thank you. The next question is from the line of Ketan Athavale from Robo Capital. Please go ahead.

Ketan Athavale: I just wanted to ask since your products are tailor made, you mentioned that and they have a trade secret, so ideally you should be able to pass on any cost increase. Is that understanding correct?

Kedar Vaze: Yes.

Ketan Athavale: So, you will pass on any cost increase and your margin guidance is 16% and revenue guidance is 12% to 15%, is that correct?

Kedar Vaze: No, 12% to 15% on the core business. So, it will translate to around 10% on the total and on the margin guidance and EBITDA level, yes 16% has been in this quarter. I see this as a very normal quarter. We expect similar quarters going ahead.

Moderator: Thank you. The next question is from the line of Bharat Sheth from Quest Investment Advisors. Please go ahead.

Bharat Sheth: Kedar, just understanding the Fragrance business, India is still contributing around 55%-60% and in last couple of years post demonetization and COVID, some of our small customers who are building up the business the way we used to call it the base business was severely affected. So, now how do we see that business is coming back or is still gone is gone or how that will really help us to grow?

Kedar Vaze: I think the dialogue is a little different. We have business with large companies. We have business with mid-sized companies and we have business with the small size traders and small companies. The small companies during the last 3-4 years have had difficult time to comply with the GST and demonetization and so many macros which affected the business environment for them. And much of this market share has got consolidated in the larger accounts and in those 2-3 years, we have seen slow growth. Now the business is consolidated. We are growing with the larger accounts as the industry is growing. So, we have no challenge for growth. The challenge was actually this migration of growth from the smaller to the larger because at that point we also had a loss of business to somewhat to the global MNC players in the market from the small. So, when business has moved from small to bigger clients, some of that business also gone to our competition. So, our market share at the small end was probably 50%, at the top end it was maybe 20%. So, some of that business has migrated to our competition in this period. So, market share did come down. But on the new market share base, now we are continuing to grow.

Bharat Sheth: And mid-size also, we are able to capture?

Kedar Vaze: Yes, it's our main business, all the accounts we are working well.

Bharat Sheth: So, how do you see sustainable India business grow?

Kedar Vaze: It will grow double digit. It depends on what is the overall industry and macroeconomic growth. If the kind of expected GDP and inflation does not come up, we will see double digit growth in India.

Bharat Sheth: Coming to this rest of world, which is also showing little slow growth. So, how do we anticipate once Indonesian facility is in the place and what are the challenges over there?

Kedar Vaze: No, I think rest of the world has a couple of countries in terms of Middle East countries like Egypt and others where a lot of currency devaluation or situation has been macro difficult, Sri Lanka; all of these countries have gone through last year bit of a turmoil in terms of economic situation and we've seen some of those businesses where we are unable to get a clarity on the payment terms or we had to exit some of those businesses. So, the rest of the world, while it looks flat, it's not flat because we've not grown. We have continued to grow in the markets. A few markets have had challenges in the last 6 months and those markets are quite sizable for us and that's why the overall impact of those markets is seen in the rest of world.

Bharat Sheth: And are we seeing now slowly, gradually that is coming back to normalization or still it will take more time?

Kedar Vaze: So, it's every country by country, countries like Egypt will take some time. I think Sri Lanka, there has been some restoration of business and it should start. Different countries in Middle East and Africa have different challenges. So, overall, some countries have come back, some regions will take some more time, some regions were not affected, so it's a mixed bag. We're talking about 50-60 different countries in this rest of the world. So, it's very difficult to pinpoint, but generally where there was steep devaluations or economic crisis because of inflation, business has been very slow.

Bharat Sheth: So, are we seeing some kind of a revival. So, the growth from 2.2 in this quarter to accelerate going ahead during the financial year end? And in the Next year?

Kedar Vaze: Yes. I think we will see big substantial part of the rest of the world, which is in the Southeast Asia. Almost half of the rest of world is in the Southeast Asia side where we will aggressively grow. In the coming years, we may put a third segment in terms of Southeast Asia and that segment will grow quite dramatically in terms of the fragrance demand.

Bharat Sheth: And Europe will continue to grow in this region, constant currency, say which is 3%. So, how do we see that also with some kind of inflation, pressure is coming down and these are kind of a little discretionary spend?

Kedar Vaze: Europe, I think we are looking at what is the growth level expected and we are focusing mainly on our margin growth. So, we see that the margin growth sort of profitability will grow the topline. We may look at rationalizing based on the volume, volume of capacity volume that we have. So, we will rationalize the product mix in a manner to maximize the capacity utilization.

Bharat Sheth: Does it mean that high profitable product will go faster and low profitable product will try to curtail and see optimize the whole portfolio to achieve your best margin?

Kedar Vaze: That's correct. We also have certain low margin businesses, which we will try to service out of India.

Bharat Sheth: So, how do we see the sustainable growth of this Fragrance business?

Kedar Vaze: So, on the bottomline, we see 12% plus growth in Europe and India as well and topline will be close to the double digit, 9% to 10%.

Bharat Sheth: And this Flavour business, how are we seeing this QSR business and how much does it contribute currently?

Kedar Vaze: So, QSR business is also part. I don't have the exact breakup in front of me, but it's maybe 25% of the overall Flavour business, but I will get back to you on that subsequently.

Bharat Sheth: Initially we were commenting that it's a little low margin business, so are we able to make improvement in by introducing new Flavours which we are doing for the whole market?

Kedar Vaze: I think the QSR business has its own life cycle and business model. So, it is doing well in relation to other QSR, we are making profit in the QSR segment, it's not loss making or zero EBITDA business, but it will continue to be lower margin business and the Flavour business. So, it's a large volume. Quantum of sales number will be higher and margin number will be lower in the QSR as a general business segment.

Bharat Sheth: And the rest of the world market also, when do we see and that can help us as you said that we expect to grow say 14%-15% kind of lower business growth. So, when do we see this rest of world to come back to our normalization level?

Kedar Vaze: So, Flavour business is normal. This quarter is a weaker quarter. Last quarter was a strong quarter. There will be ups and downs quarter-on-quarter in the export market. So, there is nothing specifically out of place in the Flavour market this quarter.

Bharat Sheth: Last question on this Global Ingredient, you said that EBIT level, still there is a loss and value is also going down say quarterly Rs.14 crore. So, how do we see that revenue run rate as well as now EBITDA is 10%? Then EBIT still will break even or EBIT will be still negative?

Kedar Vaze: No, EBIT will be +10%.

Bharat Sheth: So, next year that will help us when going to grow overall company level EBITDA margin also?

Kedar Vaze: Yes, I mean very clearly if you have EBITDA -3 for the quarter, if that becomes plus, then you will have a +4 difference between ingredients.

Bharat Sheth: And how much can be the pricing power kind of that we have in case of this sustainable say decline in raw material, which is little softer and if continues, then we have to pass on the benefit or we have to retain?

Kedar Vaze: I think the answer is very simple. There, we have not gained all the benefit or all the cost in the past. So, there is no question of passing on or we are still in deficit of the inflation that happened last year. So, it has softened from the high point, but it has not come to a level where it is below the cost of where it was 2 years ago.

Moderator: The next question is from the line of Richa Agarwal from Equity Master. Please go ahead.

Richa Agarwal: I have a few questions. So, first is on the employee cost. There seems to be a sharp rise, especially compared to the topline growth year-on-year and quarterly trend also so just wanted to understand the reasons for the same and the trend that you expect going forward. Is it likely to remain in the same range or grow further?

Kedar Vaze: I think it is in terms of the acquisition cost of employees getting added. So, when you look at a percentage of employee cost to revenue in Europe, it is normally higher than in India. So, that would be the result of that.

Richa Agarwal: So, going forward, should we expect the same run rate or further incremental expected?

Rohit Saraogi: They have the same run rate, 13% to 13.5% would be the employee cost as a percentage to sales.

Richa Agarwal: And so, this backward integration that you were speaking about, could you share some kind of timelines and what impact on overall margins that could have?

Kedar Vaze: So, it will affect the global ingredients business that as I said, which is currently in a negative EBITDA should reach (+10%) ballpark EBITDA level, and the expectation is towards quarter four this year we should be fully backward integrated.

Richa Agarwal: And Sir what is the CAPEX plan considering all this upgradation that you are talking about for nutrition and baby care and other plants that you're planning to put up in Indonesia for this year?

Kedar Vaze: So, the Indonesia plant, we have already communicated last year, it's CAPEX of between US $4 million to $5 million. The Flavour upgradation and nutrition upgradation, all these will be relatively small, maybe 7-8 crore, in total Rs. 14-15 crore for all the plants put together.

Richa Agarwal: And so, this RFQ work, I think it will take some more time, but if you could just give us some sense of what kind of revenues do you expect over next two quarters or at peak?

Kedar Vaze: So, I don't want to put a timeline to the quarter. So, the expected commercial value of this RFQ is Rs.100 crore annual revenue, which we should be able to generate from this RFQ. The timelines are a bit fluid because both at the client end and the testing has got delayed. So, full potential which we are sort of bidding for is about 7-8 times of this about 100 million. And out of that, we expect to get at least one-tenth or one-eighth of the total amount.

Richa Agarwal: And sir if you could also share how our market share in the domestic market has moved, let's say last 3-4 years for both the segments, Flavour and Fragrance segment?

Kedar Vaze: I don't have any detailed market share numbers. Let me try to compile and keep it ready for the next call.

Moderator: Thank you. We take the last question from the line of Hitesh Agarwal from Fair Value Capital. Please go ahead.

Hitesh Agarwal: I wanted to know. Could you give me the revenue contribution from Tier-I and Tier-II cities for us overall?

Kedar Vaze: We cannot give you contribution for cities because we don't supply to cities.

Hitesh Agarwal: Can you share something in regard to the new product development across our Flavour and Fragrance segments, like what feasibility we have in terms of launch of new products and how is the demand scenario across international and domestic markets?

Kedar Vaze: The demand scenario is quite robust, both international and domestic. For the Fragrance, new product development is ongoing. Nothing new to report there. It's a continuous process. We are doing at something like Rs. 50 to 70 crore of new business every year. So, we continue to work on that. On the Flavours likewise, we are looking at 15% growth to come in largely from new businesses. So, we are confident the pipeline of projects is in place and it's working well.

Hitesh Agarwal: So, what will be your revenue composition coming from Tier-I and Tier-II clients?

Kedar Vaze: So, about 50% of our revenue contribution comes from Tier-I clients and 25% comes from Tier-II clients.

Hitesh Agarwal: And do you see this revenue composition changing in the next three years?

Kedar Vaze: No. Hoping the ratio remains the same. As the market grows, new players will come in and some smaller players will become mid-sized clients and some mid-size will become large. So, this ratio is roughly the ratio of the market dynamics.

Hitesh Agarwal: Any acquisition which we are looking for in the Flavours segment?

Kedar Vaze: No, there is no specific acquisition activity right now. We will look at if something comes up, we will definitely evaluate, but there is no active project.

Hitesh Agarwal: So, like in the Flavour segment, like in the domestic market, we have a major share in revenues. So, like we are supplying to Tier-I clients in this segment, any growth kicker for us?

Kedar Vaze: Flavours, we are supplying Tier-I clients in food. We will now look at Tier-I clients in nutrition and pharma as our next customer base and accordingly upgrade the facilities.

Hitesh Agarwal: In our Global Ingredient, so like what will be our strategy for making the segment profitable? Any challenge or risk we envisage in it?

Kedar Vaze: We already talked about our backward integration that will help us to bring down the costs further and make it profitable.

Hitesh Agarwal: Sir, what will be the order book status in this global ingredient segment at present?

Kedar Vaze: At present, we are looking at Rs. 15 crore to 16 crore per month order book and we will ramp it up once our backward integration program is fully in place.

Moderator: Thank you very much. We'll take that as the last question. I would now like to hand the conference back to the management team for closing comments.

Kedar Vaze: Thank you. I hope I've been able to answer your questions. Should you need any further clarifications and would like to know more about the company, please feel free to contact our team of CDR India. Thank you once again for taking the time to join us on this call.

Moderator: Thank you very much. On behalf of SH Kelkar & Company Limited, that concludes this conference. Thank you for joining us, ladies and gentlemen. You may now disconnect your lines.

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