November 02, 2022

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 Q2 & FY 23 Earnings conference call for investors and analysts organized by the Company on Friday, October 28, 2022 at 11:00 A.M. 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: 2022.11.02 17:26:36 +05'30'

Rohit Saraogi
Company Secretary & Compliance Officer

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S H Kelkar and Company Limited

Q2 & H1 FY23 Earnings Conference Call Transcript
October 28, 2022

Moderator: Ladies and gentlemen, good day, and welcome to SH Kelkar and Company Limited's Earnings Conference Call. 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 an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded.

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

Anoop Poojari: Thank you. Good morning, everyone, and thank you for joining us on SH Kelkar and Company Limited Q2 and H1 FY'23 earnings conference call. We have with us Mr. Kedar Vaze, Whole-Time Director and Group CEO; and Mr. Rohit Saraogi, EVP and Group CFO of the company. We will begin the call with opening remarks from the management, following which we'll have the forum open for a question-and-answer session.

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

I would now like to invite Kedar to make his opening remarks.

Kedar Vaze: Good morning, everyone, and thank you for joining us on our quarter 2 and H1 FY'23 earnings call. We will discuss the operations and financial performance for the quarter. I hope you all had an opportunity to go through our results presentation, which provided details of our operating and financial performance.

We have delivered a stable performance during the period under review. The operating environment was steady across the emerging markets, enabling us to register double-digit growth during the quarter. In Europe, however, the market sentiments remain subdued, owing to the ongoing inflationary challenges. This impacted CFF Service and Fragrance segment. The newly acquired companies, Holland Aromatics and Nova Fragranze's reported healthy growth and good results. In the Flavour division, we registered encouraging top line growth in India, driven by the QSR segment in our acquisition by NuTaste. Overall, on a like-for-like basis, excluding acquisitions, our revenue grew by 6.8% year-on-year at constant currency basis, and on a consolidated basis, our sales stood at Rs. 414 crore.

During the quarter, input costs were largely in line with our estimates. However, European business was impacted with adverse currency movements, affecting the company's profitability. We have taken price hikes to offset the additional impact of currency movement. Hence despite the increases, our gross margins were steady around 39%, and our EBITDA in the quarter stood at Rs. 60.4 crore. Cash profit in the quarter stood at Rs. 49.2 crore as against a cash profit of Rs. 44.1 crore in Q2 FY'22. PAT for the quarter stood at Rs. 25.2 crore. In H1 FY'23, the cash profit and PAT stood at Rs. 91.3 crore and Rs 48.5 crore, respectively.

From the balance sheet perspective, our current net debt position stood at Rs. 503 crore as on September 30, 2022, as against Rs. 469 crore as on June 30, 2022, at a consolidated level. The increase in debt was primarily due to cash outflow required to complete the acquisition of Holland Aromatics and Nova Fragranze S.r.l. While we have a comfortable interest coverage position, we will continue to focus on reducing gross debt from the next quarter onwards.

On the business operations, I would like to update you that our participation in the RFP by the large global MNC is progressing well. Furthermore, on the back of this core listing, we are getting inquiries from other large global MNC for their India business. We believe this will support our long-term growth prospects and strengthen our position in the international Fragrance and Flavour industry.

To conclude, as we look ahead from the demand standpoint, we're currently witnessing steady demand across customers in Emerging markets. For the European market, we would like to maintain a slightly cautionary stance owing to the inflationary trends and the general macroeconomic situation. In the domestic market, after witnessing flat volume growth over the past few quarters, we believe that FMCG companies are now focusing on volume growth going forward. Volume growth bodes well for us, and we have seen subdued growth in the past few years. From a longer-term perspective, we remain optimistic that the overall demand in consumption environment, driven by this changing volume trend in the domestic FMCG industry.

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

Moderator: The first question is from the line of Bharat Gupta from Fair Value Capital. Please go ahead.

Bharat Gupta: Just to understand, Kedar, on the raw material situation. So how has been the situation, right? Because what we knew that we do import a substantial amount of quantities from European region as well as from Chinese region as well. So how has been the situation now in terms of the availability and in terms of the hikes which have been there?

Kedar Vaze: Yes. So, in general, the raw material position has somewhat stabilized in this quarter. We haven't seen any high inflation on any of the key raw materials. There is only the impact of the currency, which is affecting us largely in the European context. For U.S. dollar and Euro to Rupee, we are hedging against our exports and internally, it balances out based on the import and export. But we have not hedged in terms of USD to Euro exposure and thereby, our cost base in Europe has somewhat gone up with all the imports in USD terms. That has affected our last quarter margins in Europe. But we have taken corrective price increases in most of the large industry players, as well as competitors have correspondingly taken anywhere between 8% to 10% of price increases to offset the currency and other costs. So, we have done likewise. And that should start to show results from this quarter onwards. Overall, it is still a wait and watch. We will continue to maintain a high inventory model till such time that we have certainty on the availability and price situation or cost situation on the raw materials.

Bharat Gupta: So, I believe that the price hikes comes with the a lag. So, in terms of further hike, so do we anticipate to take further hikes or it is stable now, like if we even break it down with respect to the quarterly results, what has been the pricing hikes which we have taken versus the volume growth?

Kedar Vaze: So, the price increases have already come in the domestic market in the last quarter second half. So, we have continued to keep maintain the prices. The raw material price situation has stabilized. So, on the overall gross margin, we have improved by around 2% in the domestic emerging market area. As we had alluded, the first quarter where the price increases would have come in. The overall gross margin of 39% is subdued largely on account of Europe where the currency fluctuation between USD and euro is what has hit us in terms of the raw material. But that has now stabilized to the new norm. And we have correspondingly taken price increases or additional second round of price increases in European context.

Bharat Gupta: Also, in terms of the headwinds which we are seeing in the European market, so particularly with respect to CFF or with respect to volumes. So how are we placed now in terms of peers like where do you see the demand particularly stabilizing like over FY'23?

Kedar Vaze: So, we are still seeing robust demand. I don't see an issue with the demand. We had to be more selective during this price increase period to push for the prices and not be aggressive in our marketing. But our market share within sort of the entire European context is quite small. And CFF in Italy and Holland Aromatics in Netherlands have a good market share in those markets. We have good opportunities for exports in Middle East and Africa countries as a result of the weakening of Euro. We anticipate additional demand to come that side. And so, we see the growth still being intact. We don't see any challenges on the growth, except we are not putting very aggressive pricing because we see the uncertainty in the cost structure.

Bharat Gupta: And also, it's just a bookkeeping question. What would be the approximate currency impact on our overall revenues on profitability?

Rohit Saraogi: 1.8%.

Bharat Gupta: 1.8%. That is overall, right, on a consol basis? 1.8% you referenced in terms of overall revenues.

Rohit Saraogi: It's a translation Impact. Yes, correct.

Bharat Gupta: Also, Kedar, just to understand like when we look our growth versus industry growth, if I'm looking with respect to domestic market also. So, we seem to have been lagging behind our peers also in that respect. So, what steps we have taken further like in order to increase and in order to grow faster than the industry average?

And with respect to market share or with respect to our wallet share from the MNCs, so that continues to remain in low single-digit. So, what steps we are taking in order to further improve on it? I know we have been involved with the RFP. But going forward, what is the game plan for us in next 3 to 5 years from now?

Kedar Vaze: So, the entire situation in the last 3, 4 years, even during the pandemic and prior because the GST and demonetization years, the base of growth has shifted towards larger clients and correspondingly, our smaller clients have struggled to grow. This is sort of the general macro trend. When you overlay this to the industry, we are typically having large global competitors who have almost 70%, 80% of their business with the large corporates in the country. So, they have actually grown faster. That market has grown faster. Correspondingly, our large corporate business has also done very high-growth rates, in fact, well over double-digit growth rate in the emerging market. The challenge has been on the small customers who have had a lot of issues, first, the demand side with the pandemic and then the inflation side, for which they were not prepared. So that is something which has affected our overall growth.

Having said that, I think the early signs of kind of a broad-based growth across the domestic market is seen, which augurs well for our growth resumption, let us say, plus the global MNC business is something where we are now open. And that additional 50% of the market has opened up to us to play, and we are very confident to win businesses in that space.

Bharat Gupta: Right. Also, in terms of domestic scenarios, like you've said that tax seems to be picking up. So, any similar trades across both the segments, right, in terms of Flavours and Fragrances, both?

Kedar Vaze: Yes. Domestic, we see similar trend. Flavours also have seen robust growth this year. Exports in Flavour has been up and down. It's been like this throughout the last few years. But in average, for the year, it has given us a 10%, 12% growth. Quarter-on-quarter, some quarters can be very high quarters, another quarter could be a low quarter based on the demand and stock and the stock position of the clients. So, export Flavours is where the variability in the business quarter-on-quarter is high. But on a year-on-year, we have seen continued traction and growth.

Just on the growth, we are now looking at our next 5-year strategy in terms of additional segments for growth. So QSR, as I mentioned, with NuTaste as a segment. On the food side, we are looking at seasonings and some other sections of Flavour where we see a very large growth opportunity for us. So, the focus will be more on new markets as we are seeing that some of the existing markets in Fragrance and Flavours we are saturating. We will tap into the newer growth opportunities. E-commerce segments, modern trade segment, industrial segments, these are all segments that are growing fast, and we are tapping into those segments as well.

Bharat Gupta:	Right. Just a last bit, in terms like when we look at the RFP source, so in terms of supplying intermediates to the global players or the global indices. So, like do you see large corporate as new trend going forward for us or it can give a good amount of driver, it creates a good amount of opportunity, wherein innovators are trying to diversify their sourcing a bit?
Kedar Vaze:	Yes. So, I think the current companies are also looking to have new vendors in different parts of the world, plus they are open to innovation and localization in terms of some of the concepts which they present to their consumer. With both these trends, we are well placed, and we continue to have our manufacturer implied and supply chain audited by multiple global MNCs and that is sort of the necessary requirement for competing, which we are qualified. Now the question is to actually convert this into substantial wins. So, we have small wins here and there, but it's in progress. And we are very confident to bring home a sizable business and a sizable business opportunity going forward as we start to work and engage with the global MNC.
Moderator:	Our next question is from the line of Varun Ghia from Dimensional Securities. Please go ahead.
Varun Ghia:	My first question is, if you could provide the breakup of Flavours and Fragrance segment geographic-wise? Flavours and Fragrance revenue?
Rohit Saraogi:	Yes. So, geography-wise the split, what we have given in our earnings presentation, on the Fragrance side, so we have grown on a like-to-like basis 12%, or you want a split of the business?
Varun Ghia:	Split of business, India and Rest of the World for both the segments.
Rohit Saraogi:	So, India, it's Rs. 379 crore for H1 .
Varun Ghia:	This is for which segment?
Rohit Saraogi:	This is for Fragrance. Rs. 379 crore plus Rs. 21 crore.
Varun Ghia:	For the quarter?
Rohit Saraogi:	Which is Rs. 400 crore and flavour is Rs. 67 crore.
Varun Ghia:	For the quarter?
Rohit Saraogi:	For H1.

Varun Ghia: And for the quarter? If you can give percentage terms, it's fine.

Rohit Saraogi: Yes. And Fragrance is around Rs. 210 crore.

Kedar Vaze: Certainly, 65% is in domestic India on the fragrance. Rest is in export. Plus, Europe is there.

Rohit Saraogi: Yes, Europe is there. Europe is Rs. 160-odd crore.

Varun Ghia: And Flavour, how much is domestic?

Rohit Saraogi: Domestic for the quarter is 33%.

Varun Ghia: Okay. And secondly, if you could elaborate on this other income of Rs. 7.7 crore, what was the sale of investment property?

Kedar Vaze: So, we had office space which was rented out. It was always held as an investment property. So, we've got a good price for it. So, we sold that. That is getting converted to retail till use. So that value is increased. We have correspondingly looked at improving or increasing our office space on the higher floor so that we actually sold property on the lower floor and bought property on the higher floor in the same building, whereby we have realized the difference of Rs. 7.7 crore in terms of capital gain.

Varun Ghia: Okay. And lastly, how confident are you? Do you still maintain the guidance of 12% growth for this year, because the volumes in all in Europe have been subdued. So, do you see a single-digit growth for this year overall?

Kedar Vaze: I am still very optimistic about Europe. We have had 2 quarters of quite negative macro, but the business is coming back, there was a lot of uncertainty and people were deferring new launches or decisions. But now it has become a part of the normal and people are going about their normal consumption. So, I don't see a very big challenge on the growth in Europe. The opportunity for demand side is there. It's a question of how do we want to balance our production capacity and gross margin versus the growth. So that mix of product is where we will look at some of the challenges on the growth. But the demand side, there is no concern on the European side.

Although the macro headlines are quite negative and uncertain, the underlying businesses are not dependent much on discretionary. They are going to home care and direct use products, private labels and others, where we see continuous demand. There has been no reduction in terms of the demand. We continue also to look at export opportunities from Europe, particularly in Middle East, North Africa, where we are in a good position given the devaluation of the euro currency vis-a-vis U.S. dollars. So that has also given us additional opportunity for exports into Middle East from European operations.

Varun Ghia: Okay. And one more thing, this operational loss in the Flavour segment was mainly because of currency, right?

Kedar Vaze: So, a couple of points. One is currency. Secondly, we are now investing quite heavily in our growth on the QSR business, so almost Rs. 3 crore to Rs. 4 crore of investment in ramping up sales has gone in this quarter. And we see that the sales has also started ramping up. And so, that's sort of a lag effect because the investments in marketing and sales happen sort of 6 months before the full revenue sales number start to show.

Moderator: Our next question is from the line of Sandip Sabharwal from asksandipsabharwal.com. Please go ahead.

Sandip Sabharwal: I've been monitoring the company for a few years, and we have always talked of deleveraging, paying off debt, et cetera, from the cash flows. But after every few quarters, you tend to do some sort of acquisition, et cetera, which takes the debt up. So, what's your thinking process behind deleveraging right now?

Kedar Vaze: So I think the process is not on or off that it can happen. So, the acquisition and opportunities of business versus the reduction in debt, both are simultaneously happening. At this moment, we are not focused on actively looking at acquisitions. So, what we are completing is some of the acquisitions which are sort of second tranche or the second installment of what we have already acquired. So, we are completing all the acquisitions that we have set out to do. But we are not actively seeking any new acquisitions at this point.

Sandip Sabharwal: What's the outlook for overall balance sheet debt from where it is right now, how do you see that moving over the next 1 year?

Kedar Vaze: We are looking at something like Rs. 40 crore to Rs. 50 crore of debt reduction per quarter in terms of cash flow.

Sandip Sabharwal: Okay. And what's the margin outlook for the second half vis-a-vis what you saw in the first half?

Kedar Vaze: So, first half, as you said, first quarter was 39%. The second quarter was also 39% in consolidated gross margin. The 39% has a bit of a negative impact from the European margin, which has declined by 4% to 5%. And we expect that 4% to 5% decline in Europe to recover in this quarter as we have pushed additional price increases to the clients. And we anticipate then gross margin to be between 40% and 41% for the second half.

Sandip Sabharwal: Okay. And is there any potential of that increasing over the next 2, 3 years? Or that should be a good benchmark?

Kedar Vaze: No, it will increase. I don't want to comment specifically because raw material, when it stabilizes, we will be able to push our gross margins up in a slow manner. The manner in which the inflation has been in the last 12 to 15 months, we are still in a catch-up phase, so we will need to pass on additional cost increases to our clients in a phased, gradual manner to restore our gross margin to 43%, 44%, 45% if there is a stability around currency and raw material, then we will be in a position to do that.

Sandip Sabharwal: And lastly, like we have talked on some large order talks, et cetera, with some large MNCs. So if and when they fructify, what will be the timeline? And actually you start supplies, let's say, you win it now. So it will be next year or it starts immediately?

Kedar Vaze: It's a long process. There's basically between 6 to 9 months when they finalize the product and about 3 months after which they launched the product. So, we have in the final submission phases with a number of the projects, and we expect to have clarity by end of December in terms of where we stand with the commercial orders. But realistically, I think the revenue ramp-up will happen in next financial year. Seeing revenue ramp up from what we won last year or the bigger projects, they take longer than we anticipated. This is a global process, it takes actually multiple layers of product development in different countries. It is a longer process than the typical project, which takes 3 to 6 months.

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

Bharat Sheth: Sir, I want some understanding when you are saying that our smaller clients where they've been affected because of GST, then COVID, so is it a structural issue? Do you think overall we'll not be go back to what earlier level we were catering to the smaller client?

Kedar Vaze: So I think the nature of the smaller clients is also changing. There are many e-commerce and modern trade kind of start-up companies, which are coming as the new small clients. So this is a change process. I think the traditional small FMCG local brands, they are consolidating in each of the markets. So we've seen pretty much across the board, the larger companies taking market share from the smaller brands in the traditional segments of detergent and so on and so forth. The new age products are somewhere where the e-commerce space and modern trade is giving us a fill-up with a lot of new product wins in kind of the small markets. It's a 2 or 3-year process. By the time the new age startup and new age small customers start to grow, so there is a decline on the historical small customer segment and increase in the new start-up segment.

Bharat Sheth: Okay, fair. And coming to what kind of, I mean, revenue percentage is coming from the small client?

Kedar Vaze: About 10% of our revenue is coming from the small clients.

Bharat Sheth: And remaining?

Kedar Vaze: Remaining is coming from midsized and large clients. So, the 10% on the domestic and about 50% of our export business coming from small clients.

Bharat Sheth: Okay, fair. And now talking on this large RFPI, so where we are working since several quarters, I believe it's more than 1 year. So why it is getting delayed? I can understand 3, 6 months, what you are saying.

Kedar Vaze: No. We have applied and we've been qualified last year December. April, there should be first working proposals. And now the 6 months period where we are submitting the final design. So, this has started. So, this quarter onwards, every quarter, we will be submitting our final proposals, and then we expect that some of those will get converted into actual business.

Bharat Sheth: So as on today, it's a one client, correct?

Kedar Vaze: No, there are multiple clients in the global MNC. So, we have started with one, which we announced last year. There are other clients which have also started engaging with us, and we are working projects with them.

Bharat Sheth: So where do we stand with this other client? And when do we expect?

Kedar Vaze: So, all of these are long lead-time projects because we are entering for the first time, so 6 to 9 months is quite a normal time for these projects. So, I don't expect any large quantum of actual commercial sales by the time the projects are completed, it will be almost next financial year. But we should start to see results by end of this year and fourth quarter this financial, first quarter next calendar, we should see the results of the project development.

Bharat Sheth: And this profitability in this large client tend to remain a little lower than our smaller clients?

Kedar Vaze: Not quite. I think the profitability in terms of individual gross margin is lower, but the stock turns are higher and operating costs are lower. So, net to net, particularly for us in fragrance side, since we have the installed capacity, there is no additional cost for us.

Bharat Sheth: Okay. And is that proposal is also there, I mean, are we anticipating from a Flavour side?

Kedar Vaze: No. At the moment, for the Flavours, we have working largely with the Indian and what I would say, regional FMCG companies likes of Amul, Britannia and so on and so forth. Even on the global companies, MNCs like Unilever, Danone, Nestle, Mondelez and so on and so forth, we are engaging. But that's not on a global scale, it's project by project for some of their variants that they are launching in India. So, it's still very much India focused approach on our Food and Flavour business.

Bharat Sheth: And is there any capacity additions required or CapEx is required, major CapEx or at what capacity we are operating currently?

Kedar Vaze: I think the capacity utilization issue is largely in the European context, where we are upwards of 80% capacity utilization. Within the Emerging Markets, in India, our capacity utilization is hovering around the 50%. We can go to second shift and increase our capacity quite easily from a CapEx point of view. We would look to expand in other geographies as part of completing our 3I-3C strategy where we would look at India, Italy and Indonesia were the 3I geographies that we would compete in.

In Indonesia, we would look at setting up a facility in the near future, which is kind of identified in over the next 1 or 2 years. We also have a normal replacement CapEx within the Indian operations, which is not going to be large. So, I think in terms of big ticket CapEx, there is nothing that we need for the current business. We have, at this point, evaluating some of the new segments and new geographies. And there is a specific proposal, we will look at that, but there is no large CapEx, which is expected.

Bharat Sheth: And last question from my side. And we have our own brand at Keva, under which we are market selling in retail. So, is there any rationale for that? Or do we have any bigger ambition or slowly we'll maintain what level they are currently?

Kedar Vaze: No, we don't quite see it as a kind of a consumer retail. These retail shops and these retail outlets are catering to small industries. So, there are people who would buy this either consume at home or they would make certain products on a small scale basis like oils, hair oils, pomade, lotions, sprays, then they market it within their small geography pockets. So this is an access to the micro industries which are in our Fragrance and Flavour basis. So small bakeries, small ice cream outlets and the spray fragrance, deo producers and so on and so forth. There's still a lot of small players who buy in our retail or quasi-retail shop and they produce small industrial products.

Bharat Sheth: How many retail shops do we have currently?

Kedar Vaze: Actually, our own factories, we have only 2 in Mumbai. All the rest are third-party vendors where we are sort of distributing.

Moderator: As there are no further questions from the participants, I now hand the conference back to the management for closing comments. Over to you, sir.

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

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

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