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Dear Sir,

Sub: Transcripts of the Conference call.

BSE Scrip code / NSE Symbol: 532486 / POKARNA

We refer to above and hereby submit the transcripts of Q2 & FY18 Earnings Conference Call, conducted on December, 15th, 2017.

This is for your information and dissemination.

For Pokarna Limited


M. Viswanatha Reddy



Authorised signatory

Pokarna Limited

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Pokarna Limited

Q2 and H1 FY18 Earnings Conference Call Transcript

December 15, 2017

Moderator

Ladies and gentlemen, good day and welcome to Pokarna Limited Q2 and H1 FY18 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. I would now like to hand the conference over to Mr. Gavin Desa from CDR India. Thank you and over to you, sir.

Gavin Desa

Thank you. Good evening, everyone. And welcome to Pokarna Limited Q2 and H1 FY18 Analyst and Investors Conference Call. We have with us today Mr. Gautam Chand Jain – Chairman & Managing Director and Mr. Paras Kumar Jain – Chief Operating Officer of Pokarna Engineered Stone Limited. We will begin this call with opening remarks from the management, following which we will have the floor open for an interactive Q&A session.

Before we begin, I would like to point out that certain statements made in today's discussion may be forward-looking in nature and a note to this effect was stated in the con-call invite sent to you earlier. We trust you have had a chance to go through the documents on the financial performance.

I would now like to hand over to Mr. Paras Kumar Jain to make his opening remarks.

Paras Kumar Jain

Thanks, Gavin. Good afternoon everyone and thank you for taking the time out for joining our earnings conference call. I will briefly discuss the key highlights for the quarter and half year, post which we can begin with the Q&A session.

Starting with the top-line, revenues for the quarter stood at Rs. 85 crore as against Rs. 95 crore generated during Q2 FY17; while on half yearly basis, the same stood at Rs. 153 crore as against Rs. 183 crore reported during H1 FY17. Shutdown of quartz operation, upgradation and modification during the first quarter, coupled with challenging macros in a form of higher input price and adverse currency movement, resulted in revenue contraction for half year under review. Our quartz facility operated at close to full capacity for a large part of the quarter and is now fully operational. Our Granite business delivered relatively a steady performance for the quarter. Competitive intensity continues and we expect the overall business environment to improve gradually.

Consolidated EBITDA for the quarter stood at Rs. 29 crore as against Rs. 39 crore generated during Q2FY17, while on half yearly basis the same stood at Rs. 46 crore as against Rs. 73 crore during H1 FY17. Lower share of margin



accretive quartz business, coupled with adverse forex movement and higher input cost resulted in lower operational profitability for the first half.

Interest expense for the quarter stood at Rs. 7 crore as against Rs. 9 crore during Q2 FY17; while on half yearly basis interest outgo amounted to Rs. 13 crore versus Rs. 16 crore reported during H1 FY17, lower by 19%.

PAT for the quarter stood at Rs. 13 crore as against Rs. 20 crore generated during Q2FY17; while on half yearly basis the same stood at Rs. 18 crore as against Rs. 39 crore registered during H1 FY17. Profitability has declined on an annual basis; it has picked up on a sequential basis following commencement of Quartz operation in Q2.

Moving on to some other key developments. We have selected the location for our new engineered stone facility and are in the midst of doing the requisite legal due- diligence, which is expected to be completed shortly.

Further, in light of improving business performance, CRISIL rating agency recently improved the credit rating of the company along with its subsidiary. For the Standalone entity, Long-term credit facility has been upgraded to BBB- / stable, from BB+/ stable, while short-term credit rating facility was upgraded to A3 from A4+. While Pokarna Engineered Stone limited Long-term credit rating facility was upgraded to BBB-/ from BB+/ stable, and the short-term credit facility was revised upwards to A3 from A4+.

Lastly, the GST council as most of you must be aware, has announced lowering the tax rate for the sector from 28% earlier to 18%.

To conclude, I would just like to reiterate that we maintain our positive view on the business. We are optimistic that our new introductions, improving brand visibility and widening presence will all show in performance for quartz business in medium-term.

That concludes our opening remarks. We would be happy to answer your questions now.

Moderator

We have the first question from the line of Viraj Kacharia from Securities Investments Managers. Please go ahead.

Viraj Kacharia

I just had a couple of questions. My first question is on the Capex; so now when do we expect the plant to be commissioned, can you just provide some clarity? And have you placed the order with Breton for the machinery?

Gautam Chand Jain

As Mr. Paras has already mentioned, we are still in due diligence for the land that we have located. So, CAPEX, of course is frozen and more or less the CAPEX will remain the same and order for Breton was already placed which is put on hold because of the land issue which was earlier allotted and then cancelled. So now it is a private land which we are taking. So, all other things will follow once we have the position of the land. We do not think we should comment on exact period till we do not take position of the land and just wait for the final acquisition once the due diligence is over. We will let you know exactly about the other details once we have taken the possession of the land.

Viraj Kacharia

Just to get my understanding right sir, from the time we get the possession of the land typically how much time would it take for us to commission the plant?

- Gautam Chand Jain** Normal time is 18 months which we have always maintained, but subject to once we take the possession we will also have to review with the machines from Breton and also their installation schedule and other schedules from the builders and all. So, I think in all fairness, we should hold this discussion till we do not take possession of the land, because we do not talk in air till we do not finalize everything.
- Viraj Kacharia** My second question is; if we look at our quartz revenue in this quarter, top-line was somewhere around Rs. 51 crore while the peak was somewhere round Rs. 58 crore to Rs. 60 crore. So, what lead to this shortfall? That is one. And second, are we now looking at improved plant efficiency? So, are we also seeing an increased plant output and demand for the same?
- Gautam Chand Jain** We have done some changes for changing the product looks and mix both, and also the corresponding period if you see, we did some special project in Maldives, that was executed along with installation and all. So that was the main reason for the hike in the profit if you see compared to last quarter and corresponding quarters and also half year. But more or less, what we are still maintaining is the same EBITDA what was told all the time, in the range of 30s.
- Viraj Kacharia** Okay. And my last question; if you could just provide guidance on our quartz sales, post the debottlenecking what kind of peak sales we can achieve and also on the margin profile in quartz.
- Paras Kumar Jain** See, Viraj, in terms of peak what can we achieve, like as a strategy we are moving towards making an improved and better aesthetic looking product, so there we are not really expecting that the throughput will be higher. What we are expecting is that the realization will be better than what we currently have, that is what our this thing is. So, now what we have done is, in October first week or so, we have recently launched some new products in the market which have been accepted well in the market and which will take another three to six months to get stabilized and we will start seeing the revenues coming from there, because every product has a lifecycle, so you know you cannot run a product with best of the margins for 5-10 years coming. So, we will have to phase out the products and bring in new products from time to time, and that is what has happened during this quarter and Q3 also will be that part of it. So, we see the improvements coming largely in the fourth quarter and first part of the next year. So, I think we should not really talk about the higher top-line or the margins at least in the second part of this financial year.
- Viraj Kacharia** Okay. And if you look at our employee cost and other expenses, these have been growing at a rate of plus 20% for the past many quarters. So, where we are seeing this cost escalation happening?
- Paras Kumar Jain** See, employee cost as a strategy we wanted to have employees trained to some extent in advance for the second plant also, because what we have realized is with the competition is that employees are very critical for managing the operations of this particular business. So, we have invested in advance in some parts of the employees, so now we think that the employee cost more or less should be within the control and we do not see investing significantly on the employee side; that is one part of the cost. The other side of the cost is typically coming from the input cost, which is raw material, so you can see the crude prices are getting stronger and so are the bi-products, so the polyester resin prices are actually been on the upward only for a while now almost. The lows what we have seen in last two years does not seem to be anywhere coming in the future also. So, in the future we see an increasing trend on the resin prices as well. So, as

long as crude and bi-products continue to rise the input cost would definitely be having inflation coming there.

Viraj Kacharia

My question was on the other expenses, so I understand we are seeing pressure on the gross margin.

Paras Kumar Jain

On the quartz side, the sales and distribution expenses have been higher because we are investing into marketing significantly, like we also sponsored during Q2 we were the Gold Sponsor for CREDAI's NATCON 2017 in London. CREDAI is typically the builders association of India. So, as a baby step towards putting the product in the institutional segment we partnered with CREDAI and we became a gold sponsor, so we had to give a good amount there to be a sponsor and to be a preferred partner in a particular category. So, that part of the expenditure is going to be there. So, as and when we expand our presence towards the branding side of the business you will see that the distribution expenses would be largely be in the same line, you may not really see a tapering down happening on immediate basis.

Viraj Kacharia

What would be the quantum of this additional employees which we have on payroll for the second plant, if you can just quantify how much would that be?

Paras Kumar Jain

Actually there are some proprietary things; I would let this be passed on please.

Moderator

We have the next question from the line of Pritesh Chhedda from Lucky Investment Managers. Please go ahead.

Pritesh Chhedda

Sir, my question is on the modernization and upgradation capex. So what was the amount spent and what does it do? Does it enhance the volume or does it enhance the value? And this Rs. 50 crore to Rs. 55 crore of quarterly revenue that we have clocked on the old capacity for so many quarters, how do you see this revenue moving based on the modernization upgradation capex?

Paras Kumar Jain

Pritesh, in terms of investment in this Capex, it was not a very large number, it was relatively a very limited number, the numbers we will share with you in a while. Coming to the question on what it does typically to the plant? See, basically what has happened, when I say upgradation modification and repair, some parts of the plants have been running for almost 10 years without undergoing any large refurbishment. So, one part of the line had to be refurbished because we were saying that the output of the quality was falling down, so we had to refurbish the entire line right from calibration to polishing, the whole polishing line and calibrating line went through a complete refurbishment in terms of changing the belts, in terms of aligning the machineries and all that part of it. And now some part of modifications which were largely done in Q1 and some part of it which is being done in Q3 and a bit in Q4 which will not have really a larger stoppage requirements are to do with improving the product aesthetics. So, we are now trying to concentrate more on developing products which have got higher aesthetics values and attributes and which become very close to the natural looking materials. Because the market now currently is moving towards completely natural looking material, because this had to be one of replacement for the natural stone. So the current facility what we had in the last year had some limitations in producing this type of product, so we are now moving towards that type of segment. Now, what is the value which we will get out of it, I think more of that I can answer only during the call which we do on Q4 because now the products have been put into the market and to a limited level have been accepted also in the market. So now we have three more tradeshows coming up in fourth quarter, Jan, Feb, March, and we believe that the verdict would be largely out during that period and we are quite positive with the initial response that we have.

- Pritesh Chhedda** What is the value migration in those products, it is a 50% higher...
- Paras Kumar Jain** I think it is going to be relatively difficult one to comment, because let us look at this way that if the currency is constant then you should look at 10% to 15% migration happening on the value side there.
- Pritesh Chhedda** Okay. So, is it right that if suppose if the product was \$4 earlier then the new product line is let us say \$4.75 or \$4.8, just for example.
- Paras Kumar Jain** Yes, there will be currency fluctuations which we believe should be on the constant basis.
- Pritesh Chhedda** My next question is on the cost of borrowing side. What are we doing there, there are some opportunities in terms of further reduction and how do we see the cost of borrowing on the existing business model playing out?
- Paras Kumar Jain** See, if you look at the interest expenses also on the half year basis and the quarter basis, there has been reduction typically on the interest cost. Now, we have made some progress in terms of discussions with the bank, so what we have done is we have given the banks a timeline that by 31st December we need a final answer on all the conversion of loans what we had been talking with them for almost couple of years now. So, we are expecting that we have a consortium meeting shortly with them to get an answer, and by 31st December we are looking at freezing our options what we have with us and we are quite positive that by January we would have definitely migrated into a better position than what we are today.
- Pritesh Chhedda** What kind of reduction in borrowing cost will it be, so we will migrate entirely to dollar loans?
- Gautam Chand Jain** Yes, we are planning to migrate everything to dollar terms; reduction is going to happen between 4% to 5%.
- Moderator** We have the next question from the line of Kaustav Bubna from SKS Capital and Research. Please go ahead.
- Kaustav Bubna** When will this incremental Rs. 250 crore of debt show up on your balance sheet?
- Paras Kumar Jain** See, as we said, everything is linked to the timeline of when we start breaking the ground, and that is linked to when we start getting the possession of the land and the other permissions. So, I think give us some time, we will tell you. But what I can tell you is that not everything will come on to the balance sheet in the first...
- Gautam Chand Jain** Next year also no.
- Paras Kumar Jain** That is what we can tell you in a very limited way that it will take at least a couple of years for the whole debt to come on to the balance sheet.
- Kaustav Bubna** Okay. That's fine. And on the Rs. 220 crore of existing debt, we are planning on restructuring to reduce the rate but what about repayment of debt?
- Gautam Chand Jain** That is happening every quarter.
- Kaustav Bubna** What is the amount by which we can see a total debt reduction by FY19?

- Paras Kumar Jain** Out of this Rs. 217 crore, outside debt is only Rs. 117 crore, out of that Rs. 35 crore we are going to repay in the next 12 months.
- Kaustav Bubna** It is Rs. 117 crore?
- Paras Kumar Jain** Yes.
- Kaustav Bubna** Out of which Rs. 35 crore you are going to pay?
- Paras Kumar Jain** Yes.
- Kaustav Bubna** Okay. On your granite business, we saw good encouraging improvement in margins on a quarter-on-quarter basis, if I am right. So what lead to this margin improvement and what are we doing actually on ground actually to lead to this improvement and what is the scenario in the US, why do we expect a gradual recovery in the markets?
- Gautam Chand Jain** Let me give you first the International scenario. The competition from Brazil in granite remains very strong even now and their rate reduction has really affected all other granite products, especially the Indian products. But then the market in US is fairly good, the construction activity is buoyant and people, though they have migrated more towards quartz but they are lot of customers continue to sell granite. Now coming to our performance, as I told earlier also, the improved performance comes from the quarrying operations as well as value addition that we do in the factories, so our focus is more focused on selling a product with proper profit and also with value addition. The quarrying operations are helping out because there is improved production in the quarrying operations and also the new quarry has started producing reasonably good quantity. For all these reasons we see improved performance in granite and we hope the market continues like this and only then we can see the continuous growth happening also in granite.
- Kaustav Bubna** I mean, how much percentage of the market, what is the shift from granite to quartz, is this market sustainable?
- Gautam Chand Jain** See, the new growth in American market is happening mostly on the quartz side, unfortunately there is not much of growth happening on granite front. But then as long as we can retain the same numbers, it is still good enough because American market is a huge market for granite. So we cannot just quantify how much percentage has moved, because the whole US market is staggered into different sectors and different areas, so there is no confirmed data how much is moved from granite to quartz. But we see generally when we meet customers we see their reaction and we come to this conclusion that most of the customers are preferring to move to quartz for kitchen counter tops, but the end market for granite also remains for outdoors and also kitchens at a cheaper level and a lower level of the market.
- Paras Kumar Jain** Just adding to what Mr. Jain said, on a rule of thumb basis, we are seeing a double-digit growth in the quartz market as an industry in the US. And there has been relatively on a lower side of single-digit growth in the other natural segments of the market, be it marble, be it travertine or be it granite because US as a market imports not only granite but it has got a basket of other natural stones. So we are all seeing growth on the lower side of the single-digit in the natural stone segment.

- Moderator** We have the next question from the line of Ritika Garg from Equitas Investments. Please go ahead.
- Ritika Garg** Could I know the breakup of exports for granite and quartz for this quarter?
- Paras Kumar Jain** 99% was exports in quartz and 61% was granite exports.
- Ritika Garg** Which are the major countries that we are exporting to?
- Paras Kumar Jain** See, basically the largest proportion, in terms of quartz goes to the US market. Granite, because we also do block and slabs, you should look at China and US as a combination.
- Ritika Garg** Okay. And sir, most of our raw material is locally sourced or it is imported?
- Gautam Chand Jain** In granite?
- Ritika Garg** In both.
- Gautam Chand Jain** No, actually in both it is locally sourced honestly, but in granite most of them comes from our own quarry, and quartz is also locally sourced.
- Ritika Garg** Okay, so both are locally sourced. So, with the rupee appreciation and the increase in raw material prices, how do we expect to sustain our margins?
- Paras Kumar Jain** See, coming to the quartz side, with the rupee being strong and dollar being a little this thing, so that is definitely going to be a challenge. So, while we are looking at the other cost initiatives, but how much of that can be really made up is definitely a challenge. So, we do not see really a large 40% plus margins coming in the quartz at least for the next two quarters. But our challenge and our priorities today are to maintain the numbers to what we have been always maintaining around, 35%.
- Ritika Garg** But even that is looking like a challenge?
- Paras Kumar Jain** It is a challenge but it is not really a herculean task, I can say.
- Gautam Chand Jain** We are also trying to come up with new innovative products.
- Ritika Garg** But how long will these products take to come on-stream?
- Paras Kumar Jain** See, there are two different stages of a product basically, one is the initial birth stage, birth stage is when we conceptualize a product in a laboratory, take it to the plant. So, that sometimes typically takes anything between two to six months, and that phase of the product is already achieved. And the second is when we actually put the market for commercial test in the market, that has also been done now to a limited extent in the current quarter which is under progress now. So, it typically takes anything between three to six months for the final verdict to be also out once the product is put into the market. So we expect that we will have the right answer by March end on the fate of all these new products what we have put into the market in last three months.
- Ritika Garg** How many new products have been put in and what kind of revenues do we expect in the next year from the new products?

- Paras Kumar Jain** From the new products it would be difficult to give you revenue estimation because they are in the test phases now, so I would abstain from answering that. But what I can tell is that we have put close to 21 products in the market and at least half of it already seems to be getting traction from the market.
- Ritika Garg** Okay. And most of it would be in quartz or granite?
- Paras Kumar Jain** Actually typically almost everything is from quartz.
- Gautam Chand Jain** And this will also replace some old products, please do not forget that.
- Moderator** We have the next question from the line of Vishesh Arora from Laburnum Capital. Please go ahead.
- Vishesh Arora** Two questions, first is that for the new factory what is the timeline that we have and have we bought the land, has the financing been done and how much debt will this involve? Second question is, is there sufficient demand for high end quartz in India? The product actually is more expensive than some of the lower end Chinese manufactured stuff, so why do people pay a premium on this?
- Paras Kumar Jain** See, the first part of the question I think we already answered in terms of the timeline. So, as Mr. Jain said a little while ago...
- Vishesh Arora** Sorry, I joined the call late, so if you could repeat that again for me.
- Paras Kumar Jain** Yes, I would do that for you. We are amidst doing legal due diligence for the land and it will take a while for the legal due diligence and the other formalities to happen. So, we do not really want to give you a date to start with, but typically from the date we get the land and the related permissions, it typically takes about 18 months, subject to other vendors also matching their delivery schedules which they had given in the past to us. So, we are hoping that about 18 months, with whatever riders I have mentioned we should be able to execute the project. And coming to the second part of the question on why do products get a premium, there are various attributes. The Chinese products per se have got various limitations in quality, whether it is the performance of the stone in terms of staining, warping, cracking, and there are other various mechanical aspects. So, while to an end consumer it may look like a stone but the consumer who understand the behavior of the product would be able to appreciate what are the differences. And of course it is a challenging task for us also to educate the Indian consumer about why a Breton stone is better than a Chinese stone. And we are making that effort in all our discussions and all the industry forums what we use to say why Breton stone is better than any other Chinese stone, because whether be it the composition of the raw material itself or be it the technology involved or be it the polishing aspect or be it the installation aspect, there are various reasons why the product actually outcores all the other products and demands the premium.
- Gautam Chand Jain** I would like to continue here, that even the optical look of the product what we can do in Breton stone plant cannot be done in the Chinese plant, because this is fully automatic plant where the capacities do not really undergo substantial change. But one of the answers for one of your question also is that, for example, IKEA has selected to use only our quartz in the forthcoming business they are launching in India exclusively from us. Now, they are also using Breton stone plants world over and they have an experience and there is a reason they do not touch Chinese machine made products for their counter-tops. So, obviously there is a value to the product and the price that consumer pays for that value.

- Vishesh Arora** On the first question how much debt will the new factory, the land and financing involve?
- Gautam Chand Jain** This will remain the same what we have projected of Rs. 250 crore debt.
- Paras Kumar Jain** Banks have been tied up basically.
- Moderator** We take the next question from the line of Rajesh Kothari from Alf Accurate Advisors. Please go ahead.
- Rajesh Kothari** Sir, could you give some color on what is the overall demand outlook in US market? Question number two is; once your new plant comes on-stream, what is the asset turnover on peak basis and by when do you think you may be able to achieve that? And third question is, of that additional revenue do you think you will be also supplying beyond US? If yes, then which are those markets and what will be our competitive position in those markets?
- Paras Kumar Jain** See, coming to the second question first in terms of the asset turnover, Rajesh, if you recall our discussions in the previous conference calls also, we have been maintaining that between 1 to 1.25 is the asset turnover ratio in what we are looking at. Now, how much of additional increment can be made to this ratio is something which we cannot comment at the moment, it only depends upon how we bring in the new products on this facility, because we are trying to do something different in this facility which probably should be able to give us some incremental revenue, but those will have to be tested. So that is the answer in terms of the asset turnover.
- Second, definitely the geography expansion for the market is on cards, so we are already looking at various other geographies, even before the new product comes in the market. And all those geographies which we have been looking are the markets where we have not been traditionally present in a large way or have not been present at all. So we want to expand our forte definitely beyond the US, while US will definitely continue to be largest portion of the market for various reasons, including the demand, outlook and the position of the market. But the markets like India, Europe, Australia and other parts of the world will also get equal focus from our side. How much of that will get converted into the business is a question, but the focus would continue definitely beyond US much before the new line is operational, which is already happening currently.
- Rajesh Kothari** And my first question was, what is the demand outlook on US market? And just one more additional question to that because I missed your first five minutes of the conference call, what is the reason why the second quarter was also very subdued on YoY basis in your quartz business?
- Gautam Chand Jain** I have been just back from my US trip and I see that the demand for quartz continues to grow and more importantly the natural stone companies which were not earlier focusing or even interested in quartz are now all part of the quartz market now and everybody wants to sell quartz. In terms of the volumes, I do not have any data to tell what percentage or how much growth will happen. But meeting the most important customers in the whole of US for three weeks I can tell you that the demand for quartz is continuing to grow and will grow is what the indication everybody gave me.
- Rajesh Kothari** Good to hear that. And can you also answer my last question, I missed your first five minutes of your conference call, may be for sake of repetition if you can, what resulted in the de-growth in your quartz business on YoY basis in second quarter?

Paras Kumar Jain

See basically, Rajesh, if you look at the first quarter we had a shutdown of the plant from almost 10th of May to 23rd of June. So during the Q1 period we had our little prolonged shutdown, which contributed to the half year revenues getting contracted. And coming to the Q2 part of it, as Mr. Jain mentioned that in the corresponding quarter of the last year we had done a bit of installation part of the project also which had our revenues getting recognizing in the Q2 of the last year, which was not there during this part of the year. That was on the revenue side. On the Q2 margin contraction at the quartz side, the reasons were that we had a higher input cost because you see the crude prices and the rated bi-products prices whether it is phthalic, malic, styrene are all the other aspects, all getting on the higher side, on the north side of the curve. So, the polyester prices have firmed up significantly and in general there has been a price hike. And added to it there has been a bit of Rupee strengthening which is also a negative to us. And then we have not been able to pass on this price increase to the customers for business reasons. And then we also focused aggressively in terms of investing in the sales and distribution expenses by doing some aggressive advertising and sponsoring some events. So, this added to a bit of contraction in the Q2 of quartz.

Rajesh Kothari

Okay. So, from Q3 onwards seems for the first time we are hearing this that last year second quarter had some kind of revenue which was probably not recurring in nature. That kind of revenue would be there even in third quarter and fourth quarter?

Paras Kumar Jain

It is difficult to predict, because see it was a first experiment which we did during Q2 of taking the turnkey project, we did not only supply of the material, we did a cut to size, we did even install and delivered the villa through a subcontractor. So that is definitely a business model which is not recurring in nature, so getting a revenue from a service part in quartz will not really be a revenue which is recurring in nature, unless and until the IKEA buildup happens and you have a service component coming up. But that is only happening in the FY18-19 to start with, that is not going to happen in this financial year, the service revenue part of it.

Rajesh Kothari

I see. So, in FY17 in second half there is no such revenue which was there earlier?

Paras Kumar Jain

There was no large revenue of that was there in the second-half, but the second-half did well because we had some product introductions and we had some new customer addition happening and things went that way. So, we see that the second-half of the year will not really be a very aggressive in terms of this thing, but it would be a reasonable one, the second-half, on quarter-on-quarter basis a little aberration.

Rajesh Kothari

So, do you think the margins will now normalize, are you able to pass on that price increase?

Paras Kumar Jain

Rajesh, if you recall our previous discussions also, while we have maintained 35% we have delivered in excess of 40%. So, we are eager to maintain 35% and let us see what comes through.

Moderator

We take the next question from the line of Pankaj Shah from Avenue Capital. Please go ahead.

Pankaj Shah

Sir, what will be the moratorium period in the new Capex debt?

Paras Kumar Jain

Two years for construction and one-year moratorium, total three years.



- Pankaj Shah** Okay. So this will be once the commencement happens, right?
- Paras Kumar Jain** Yes.
- Pankaj Shah** Do you see any pricing pressure in the quartz as Seasonstone is also planning to move into the lower pricing segment in US, like we had gone through some of their management commentary.
- Gautam Chand Jain** You are right, because everybody wants to adjust to the market demand from time to time, and unless there is an innovative product which can fetch a better price, we need to be competitive in the market today. So, competition coming from the Chinese produced machines also drives you to make low end products to satisfy the market. So, this is a game which will continue, in fact we will need to have a product mix right from the lower end of the product market to the highest possible and keep upgrading our product to get better realization. That is what the quartz business is all about.
- Pankaj Shah** Right. And sir, in one of the calls you said that company has long-term supply agreements for raw material for quartz, so how pricing is determined and how frequent there is price hike from the supplier and how frequently we increase the prices for the final product?
- Gautam Chand Jain** Pankaj, we do not increase the price at all, because when a product price is established for the end product it is very difficult to ask for an increment, that is why we go in for new product innovation and discontinue some products where the realizations are low. As far as supply of quartz is concerned, consistently we have renewed the contract with the same supplier from the day one till now and in the future, so there is no issue of the quartz supplies. Price increase, yes we do have to give price increase, though we do not get price increase in the same product. But that is once a year phenomenon and some exceptional cases in between but normally it is not very frequent, it is once a year.
- Pankaj Shah** Okay. And sir any opinion on laminates as alternatives of the quartz, I mean though we agree that laminates is already a big part of the entire pie, do we see any shift from laminates to quartz?
- Gautam Chand Jain** Yes, actually the action market what quartz is eating is into laminates market. Originally especially when we talk is always mostly American market because we focus on that market. Originally all the kitchens in the US used to be laminate kitchens and the upgradation is happening for those old kitchens also to either granite or quartz, depending on the size and shape of the project it is. But the market definitely is moving and that is the reason we have some of the world's biggest laminate producers as our customers now for quartz.
- Pankaj Shah** Okay. And sir Seasonstone is also a key quartz supplier in US and that company operates at close to 18% to 20% EBIT margin, whereas Pokarna operates at 35% plus operating margin. So, do you see any threat in future, may be not today?
- Gautam Chand Jain** As I told you, see we have to be keeping our eyes and ears open all the time to meet the competition. Right now, we are able to produce a product which can fetch us a better profit, we are making that. Maybe we are looking at even improving the further margins. But why Seasonstone's profit is less, I am sorry I will not be able to comment, it is their own market, though they sell products even at higher price than us, probably it may be efficiency, or I do not know. Their overheads must be higher than us; their raw material sourcing must be higher than us probably.

- Pankaj Shah** Okay. Any update from the IKEA deal which we had entered in India?
- Gautam Chand Jain** Yes, we have already done a mock-up for them now as they wanted to do a show display area for IKEA's forthcoming shops in Hyderabad. And we have already done the mock-up for them. And once IKEA launches only then we will know what will be the volume, though their projections are good and very big. But let us see how it moves. One good thing is that we are the exclusive vendor for this product which has been signed, so that will give us definitely a good opportunity.
- Pankaj Shah** And sir, IKEA deal is only for quartz, right, it is not for granite?
- Paras Kumar Jain** No, they do not use granite, unfortunately.
- Moderator** We will take the next question from the line of Shashank Manila Walla from Moneylife Advisory. Please go ahead.
- Shashank Manila Walla** Just a small confusion, you told it will take 18 months to complete the new plants, so you are talking 18 months from now or 18 months after the land acquisition completes?
- Gautam Chand Jain** I would say again that it will be always land acquisition, because if it is tomorrow then we can start counting from tomorrow, but it is after 10 days we have to start counting after ten days obviously. So, this is a standard time which normally is a time that we always calculate, may be few days less or more. But that is how normally Breton calculates the number of days.
- Shashank Manila Walla** And can we assume that there will be only normal growth for another 18 months, six quarters or can we expect some better growth than what we have seen in past few quarters?
- Gautam Chand Jain** No, I think we told that earlier also that we are working to full capacity. And only growth can happen or de-growth can happen provided the machines are not working for few days or we have better yields coming out of the color mix that we make. So, more or less, this is optimum capacity we have been working, last year what you saw numbers. Little bit of improved efficiencies can give us good numbers.
- Shashank Manila Walla** Okay. So only if there is a better operational efficiency then we might see some improvement in margins, otherwise on the top-line side it is going to be flat?
- Gautam Chand Jain** The order we get from customers on what product. Efficiency also depends from color to color.
- Shashank Manila Walla** Okay, so that is variable, you cannot say anything concrete about it..
- Moderator** We take the next question from the line of Pranoy Kurian from Ambit investments. Please go ahead.
- Pranoy Kurian** I just want to ask you about capital allocation. Given that this project cost is around Rs. 325 crore, so any thought as to why it was Rs. 250 crore in debt, given the last cycle and given that that means there is always a possibility of the US market slowing down. Did you guys explore thinking of raising equity instead?
- Gautam Chand Jain** See, when we thought of putting the project, first thing what we wanted to do a financial closure to decide on the project. So, based on that our bank was willing to fund it and we have accepted the proposal and gone ahead with closing the

financial closure and going ahead with planning to put up the project. Going down the line, maybe we will explore options, possibilities.

Paras Kumar Jain

Definitely the capital structure would be considered at the right time. So, since we had some other priorities so we took that route which was quicker. And we believe that once we have size and scale then the options to consider would also increase. So, I think with due course in time we will definitely have a look at the capital structure.

Pranoy Kurian

That is even, okay let us say in the next three years do you envisage that if your debt equity goes beyond say 2x, like do you have some internal limits as to where it should not cross?

Paras Kumar Jain

There is an internal benchmark we would want to maintain, but then it is also influenced by the other external factors. So we take your point well that we have to reconsider, but I think it would be difficult to comment anything on that currently. But the suggestion is well-taken and we definitely have that on our cards also for a while now.

Pranoy Kurian

Then just one last question, with this new CAPEX you are essentially doubling your capacity, right?

Paras Kumar Jain

We were adding almost 130%.

Pranoy Kurian

And from a demand point of view this 130%, I mean how many years you internally do project being able to meet that 130% in terms of utilization?

Paras Kumar Jain

See, typically what happens is when you start up a plant to scale it up to the optimum level of capacity utilization itself takes two to three years minimum. So, we believe that between three to four years of the cycle we should be able to run at an optimum level of capacity.

Pranoy Kurian

Within two to three years?

Paras Kumar Jain

Three to four years. Two years takes for the plant to come to an optimum cycle, so we do not want to go to the market and say that I am going to deliver you x while I can only deliver you x-5. So, we want to typically go into the market with what we can deliver, because markets where we operate the commitments are quite stringent. So, we want to only commit when we have completely reached to that scale. So, we believe that three to four years typically takes for the peak out to happen completely.

Pranoy Kurian

Okay. But can you give us some example of why it takes three to four years to ramp up, I mean is it some...

Paras Kumar Jain

You can look at the current example, I do not want to name the competition, but you look at when they have set up the plant and where are they currently. So, it is not something which is easy to operate, it is not a processing machine that you bring a machine and you start cutting and polishing like granite. This is a completely different manufacturing process and it is completely robotic line, so establishing a product line, training the people online. That is the reason if you recall one of the questions which I had answered also in the beginning that we have to invest in people in advance, because that is the learning what we had. And whatever we invest, still there will be some gaps is what we see. So, that learning, because if you go back even in the history of this plant what we had, that itself took us at least close to four years to stabilize completely. So, for that

much period I think that is typically we call it as a biological period, but if something happens quick in advance we would be happy to report that.

Pranoy Kurian

And you spoke about the other quartz market, like Australia and other thing, so from what I have been reading that a lot of these other markets have a much higher share of quartz than the US, right, like Europe and Australia they already have a high penetration of quartz. So, I was just wondering is there some reason why they differ from the US.

Paras Kumar Jain

See, every market has its own nuances typically. So, US market actually, if you look at even the size of the market is the first question one has to look at. The size of the stone market in Australia and Europe combined will actually be less than the market of the US as a territory. Completely penetrating and converting that thing would be impossible, and with the different product evolutions happening the replacement ratios will not be that quicker, that is one aspect of it. So, I think whatever you say, our estimates always have been that US market one side and rest of the world stone market on the other side is typically how we evaluate, that is the size of the US stone market.

Pranoy Kurian

No, I am not really talking about your ability to penetrate.

Paras Kumar Jain

No, even everybody's ability. I am saying that if you look at the size of the market, if you have to replace the ratios of other stones in one country vis-à-vis replacing across the world also still US will be difficult to replace is what I am saying.

Pranoy Kurian

Yes. I agree with that, so I think I saw like 10 years back or something it was in single-digit quartz as a percentage of the market, but I think in Australia and Europe it was a much higher percentage.

Gautam Chand Jain

Australian market is a very small market.

Paras Kumar Jain

Let me now give you a statistic, you should look at this way now that the conversion rate happening or the growth in the US market now happening is much higher than the growth of the quartz in the other market. Because if you look at the month-on-month imports happening in to the US market there is a less than 30% growth and no other market is giving a 30% import expansion in quartz market anywhere. All those markets have reached maturity and US is still the rising star.

Pranoy Kurian

Sir, I am saying from our point of view, since we are still at a smaller level in terms of revenue, for us the addressable market is still very big, so regardless of how the end customer is doing we can still try to make inroads say in Europe for example.

Paras Kumar Jain

Yes, if you look back I think you missed a bit of conversation which I had in the middle of the call when I think Rajesh from Alphaccurate asked this question, how about you getting into other geographies. So, other geographies are definitely are on the cards, some of the geographies we are already making efforts to penetrate. While the markets are small but we still feel that there is a pie which we can have. So, that effort and focus on those markets apart from the US is already on and we will definitely see the results much before the new line comes into operation.

Pranoy Kurian

Just last question, who would your key competitor be in some place like Europe, I mean what will be a challenge for you to enter those markets?



Paras Kumar Jain

See, basically if you look, for us the geographies of America, you have Breton stone players already producing in America. And Breton stone players from Europe and Asia, like Vietnam are also selling into US market. So, the competition for us is like anybody who is into Breton stone manufacturing. And to some extent sometimes the Chinese also become a competition when you are typically competing on a commercial side of the project. So, if you look at players like DuPont which is a multi-billion dollar organization, they are also into quartz surfaces, then you have LG also into quartz surfaces, then you have Seasonstone and Silestone. So, I think the competition is not from geography typically, because we compete not only with the people from our own Asia, but we also compete from Europe, from US, because US also has now manufacturing facilities.

Moderator

Ladies and gentlemen, that was the last question. I would now like to hand the conference over to the management for closing comments.

Paras Kumar Jain

Thank you. We look forward to talking to you again in the Q3 Call. Have a nice day.

