



“S. Chand and Company Limited Q4FY17 Results Conference Call”

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MODERATOR: MR. ADITYA BAGUL - AXIS CAPITAL LIMITED

Moderator: Ladies and Gentlemen, Good Day, and welcome to the S. Chand and Company Limited's Q4FY17 Results Conference Call hosted by Axis Capital Limited. As a reminder, all participants' line would be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference call, please signal the operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Aditya Bagul from Axis Capital Limited. Thank you and over to you, sir.

Aditya Bagul: Thank you. Good evening, everyone. On behalf of Axis Capital, I welcome you all to the earnings conference call of S. Chand and Company Limited for fourth quarter FY17 and the full year. We have with us today from the Management Team of S. Chand, Mr. Himanshu Gupta – Managing Director, Mr. Samir Khurana – Head (Strategy & Investments) and, Mr. Saurabh Mittal – CFO.

I request Mr. Himanshu Gupta to give us a brief overview of the results and to share his outlook for FY18, post which we will open the call for Q&A. Over to you, sir.

Himanshu Gupta: Thank you, Aditya. Good afternoon, everyone and welcome to our fourth quarter and full results conference call of FY2017 of S. Chand and Company Limited. This is our first call post the listing of our share and also a review of the full year performance.

Some of the notable highlights for 2017 include:

The group clocked annual revenue of Rs 6.85 billion, registering a growth of 27% year-on-year. This includes organic growth of 13.3% and consolidation of Chhaya revenue from December onwards which added Rs 750 million to the group revenues. Our K-12 business registered an organic growth of 21% and helped us continue with our leadership in CBSE and ICSE schools content market. We are the largest content players with CBSE and ICSE schools and are working very hard to increase our market share in this segment.

We closed the acquisition of Chhaya Prakashani in December of 2016 and diversified into the state board publishing market. Chhaya is a market leader in West Bengal State Board market and has an established brand and distribution presence in this market. Chhaya on a full year clocked revenues of around Rs 1.02 billion.

Our group EBITDA for the full year was Rs 1.72 billion, margins being 25% of operating revenues. Our digital business contributed to full year revenues of Rs 310 million, registering a year-on-year growth in excess of 30%. The digital business comprises of two key products – smart class product – Destination Success, which is currently deployed in 5,300 classrooms; curriculum solution product – Mylestone, which was commercially launched during the year and is now implemented in more than 68 schools.

We successfully closed our IPO last month in May and raised Rs 3.25 billion. We have utilized these funds to deleverage our balance sheet by around Rs 2.5 billion. Q4 is a very important quarter for us and it contributes close to 80% of our full year revenues. Most of our K-12 business happens in this quarter and hence the higher contribution. K-12 constitutes 80% of our total annual business and Q4 contributes 78% to our annual revenues. We are currently focused on executing our strategy of increasing our presence amongst schools, educators and student as a content provider, with focus on both central and regional curriculum schools. We want to have a larger wallet share of the content market, be it in the digital or print form.

New initiatives are planned for the year to improve printing efficiency, upgrade content, expand our brand reach and ensure we continue to play a meaningful role in imparting knowledge to students and educators.

Our Group CFO, Saurabh Mittal, will now explain the financial performance for the quarter and full year in detail.

Saurabh Mittal:

Thank you, Himanshu. Good afternoon, everyone. I will take you through the key highlights of the financial performance of FY16-17.

Our revenues have increased from Rs 5.46 billion to Rs 6.85 billion, a growth of 27% which includes the consolidation for Chhaya Prakashani which was acquired in December 2016 for a four-month period. The gross margin is stable at 60.8% partially impacted by rationalization of inventories, but continues to remain strong. EBITDA is at a healthy 25.1% which has increased from Rs 1.28 billion to Rs 1.72 billion, which is an improvement of 140 bps, aided by the consolidation of Chhaya which is a higher EBITDA business. There is a partial impact of one-time charges for the acquisition of Chhaya including its integration and IPO readiness expenses.

Our PBT has grown a healthy 49% from Rs 725 million to Rs 1,091 million, partially impacted again by interest charges for the acquisition of Chhaya; subsequently, we have deleveraged the loans. Our PAT is higher from Rs 493 million to Rs 655 million; this is before the minority interest, which is an increase of 33%, this is due to higher incidence of tax.

Our net debt as on 31st March is Rs 3.4 billion, from which we have now repaid about Rs 2.5 billion. So, our present net debt is down to about Rs 200 million only post the IPO funds that we have also raised.

On the working capital side, net working capital has reduced from 262 days to 244 days, this is despite the demonetization impact on Chhaya Prakashani and a couple of other businesses. We have been able to rationalize our inventories. Finished goods ex-Chhaya are lower; we have kept up raw material inventory anticipating an increase in paper prices for the current year.

Apart from that, some other key highlights:

Our royalty costs are at a stable 6% which is a structural change from the previous year and we will continue to be like that. And going forward, we expect a huge benefit from interest cost due to the paid back loans of Rs 2.5 billion.

On the GST front, the impact that we see is 2% increase in tax rate for paper; other services of course there is an impact of 3%. On the finished products, books there is a nil rate except for certain items; so, we expect only 5% of our total revenues to be impacted by any GST rate that has come in, that will be basically on the digital business, lab manuals and some education scripts that we do.

Finally, of course, the results are on Indian GAAP. IndAS is applicable from the 1st of April and we will be presenting our first quarter numbers under IndAS. Thank you.

Moderator: Thank you. Ladies and Gentlemen, we will now begin the question-and-answer session. We will take the first question from the line of Nagaraj Chandrashekhar from Laburnum Capital. Please go ahead.

Nagaraj Chandrashekhar: Just wanted to take down more on the improvement in working capital we have seen this year. What really has driven this thing, can you get back to the levels you saw in FY12 before you embarked on these three or four large acquisitions? That would be my first question. The second would be, what would be sort of your path way to improving your returns on capital to closer to those of your larger listed peers, could you now use more leverage to finance working capital, sort of improve returns on equity going forward?

Saurabh Mittal: On the working capital front, as you are comparing financial year 2012 to 2017, there will be a structural change in the mix of the revenues. In FY12, our revenues from school education were about 50%, presently about 80% of our revenues are from school business. School business is a Q4 business, so as on 31st of March our working capital will definitely look higher, but once you see it in Q1 and Q2, and Q3 we will recover most of the receivables and working capital position definitely looks better. On the RoC, Samir, would you like to respond to that?

Samir Khurana: On the ROC front, if you look at the RoC that has been impacted because of digital investment. So, if you net off the digital investment and you normalize for the one-time cost and the part of Chhaya business which is not consolidated, then the RoC on an average capital employed basis comes to 19.7%. The reason why we are taking of average capital is because as you know the business is predominantly in Q4 which makes the capital employment as on 31st March to be very disproportionate to the average requirement during the year.

Moderator: Thank you. We have the next question from the line of Anantha Narayan from Credit Suisse. Please go ahead.

- Anantha Narayan:** I had two questions, my first question, I guess if I were to point towards one weak spot towards higher education business in FY17, any particular reason why it declined and what is the outlook for FY18? That is my first question.
- Himanshu Gupta:** I would like to answer that question. So, in FY17, the higher education business, basically if you see the revenue decreased by 5% to Rs 1.2 billion and the test preparation business out of that registered a growth of 6%. So, we feel the college business has been showing headwinds over the last two or three years, but we believe that this year for the higher education business overall we would like to give a guidance of around 8% to 10% growth and we feel the business is going to recover, because a lot of efforts the company has done in making sure we have a better sales team, we have better product portfolio and we have a stronger presence in the higher education business. But over last three or four years, there were strong headwinds because a lot of colleges, universities, a lot of private colleges had got shut down, a lot of consolidation had happened in the higher education market. I think now it is more stabilized, even the company's product portfolio and the sales team have also more stabilized, so we believe that this year we will register a revenue growth of around 8% to 10%.
- Anantha Narayan:** And my second question to Saurabh was, do you have any indication of how different the Ind AS numbers would be from Indian GAAP?
- Saurabh Mittal:** So, we have done an initial assessment last year looking at the numbers; they are not too different, actually on the profit and loss side the numbers do not change substantially. There will be some change with regard to the way goodwill is accounted for; this again is not very substantial. So, I do not see a material change from the Indian GAAP.
- Moderator:** Thank you. We have the next question from the line of Aditya Bagul from Axis Capital. Please go ahead.
- Aditya Bagul:** Just a couple of questions. First, there appears to be a reduction in terms of royalty cost if you look at it on a percentage of sales basis. What could be the reason for that and is this more of a structural issue or is it more temporary?
- Saurabh Mittal:** So, this is a structural change. The two things that we have done is we are concentrating more on in-house title.
- Himanshu Gupta:** Sorry, Aditya, I will interrupt here. So, basically royalty cost has come down to 6% because of in-house content development and the new agreement that we are doing are also at lower royalty cost. And we believe the royalty cost will stabilize at a 6% levels in the coming future.
- Samir Khurana:** And Aditya, I think what is also very important to note is that in the last two years we have spent a lot only on creating a content team. So if you look at the size of the content team, there is over 200 people now and the idea two years ago was to focus more on creating in-house content, upgrading in-house content, and that has started to reflect in the royalty trading. Having said

that, we believe that 6% is pretty much stable, we do not expect a very significant drop or increase from the current 6%.

Aditya Bagul: I am sorry, I believe you said you do not expect a material drop from 6%?

Saurabh Mittal: No, we expect it to stabilize at 6%.

Aditya Bagul: That is quite useful. Sir secondly, if I may ask, you mentioned something on the debt paring down. Could you also help us understand what would be the impact on the interest cost because I believe we have some Rs 30 crores odd interest this year? So, how would that number look like in FY18-19?

Himanshu Gupta: So, Aditya, we have actually repaid debt of close to Rs 2.5 billion and as business stands now we have a gross debt of about Rs 100 crores or Rs 1 billion, against which we have some free cash of I think some Rs 70 crores - Rs 75 crores. So, net-net, we have Rs 200 million or Rs 20 crores of net debt. On a full year basis, we expect the interest cost to substantially reduce because if you look at the total debt as of 31st March, approximately 40% to 45% of that is towards the acquisition which we do not expect to continue this year.

Aditya Bagul: So, would I be wrong in assuming that there would be about a Rs 20 crores odd savings in interest, would my number be correct?

Himanshu Gupta: Yes, we expect at least Rs 18 crores to Rs. 20 crores of savings.

Aditya Bagul: Operator, do we have any more questions?

Moderator: Yes, we have one more question, that is from the line of Nagaraj Chandrashekhar from Laburnum Capital. Please go ahead.

Nagaraj Chandrashekhar: Could you give us a sense of organic growth rates that you see in each of the end markets like you mentioned for higher-education in your answer to the earlier question? And also some comments on the size and the kind of quality on the pipeline that you have right now?

Himanshu Gupta: So, the company expects to grow at a consolidated level of around 14% to 15% next year on organic basis, which includes revenues of around 80% coming from school and school business to grow at around 18% to 20% organically, and the higher education business as I said earlier to grow at around 8% to 10%. And if you combine it together, it will be close to around 15%, that becomes the plans to grow organically in the next year.

What was the second question, sorry?

Nagaraj Chandrashekhar: On your pipelines for acquisition?

Samir Khurana: So, basically our investment philosophy is two-fold: on the publishing side, we basically look at businesses that can complement our portfolio or such brands in the regional markets. On the acquisition side there are a couple of opportunities that have come up, but nothing material. Nothing significant has been materialized as of now. It is very early to give guidance on that. On the digital side, we are looking again at various investment opportunities that can be synergetic to our content portfolio. So that again is a ongoing process, we are evaluating a few opportunities, but we are not at a stage where we can disclose.

Nagaraj Chandrashekhara: And what would be your internal hurdle rate for acquisitions that you do?

Samir Khurana: On the acquisition that we do, we typically look at businesses that are approximately Rs 100 crore of top line which are growing in line with the industry which is at least 15% CAGR and businesses that have an EBITDA margin which is in line with the school business, the school business is typically around 30% odd of EBITDA. And, in terms of valuation, we have historically followed a certain pricing formula for the three acquisitions we have done, and we hope to look at valuing future acquisition using that same framework.

Moderator: Thank you. Our next question is from the line of Jasraj Singh, an individual investor. Please go ahead.

Jasraj Singh: Sir, my question is regarding the digital business that you have. How is it charged, is it based on per child basis or per school basis? And what is the potential that you see in this in the next three to five years? And my second question is on the start-ups where you have invested in three start-ups. Would you be participating in the next round of funding also for these start-ups or is it like only in the initial rounds that you have participated?

Himanshu Gupta: Right. So, basically the digital business which we have, in that the business is of smart schools is on a per classroom basis per month; so, we charge the schools on a per classroom basis, and that depends on the size and number of students and how many classrooms the school is taking. Is it taking hardware or is he taking only software, so there are a lot of factors, but it is on per classroom basis. And your second question was on the start-ups. On the start-ups we have invested close to five start-ups, and three start-ups last year have gone for next round of funding and depending on the start-up situation we have invested in the second or third round of fundings as well. But it is not always the case that we need to be a part of the start-up, but if we feel, if the company feels that we have a potential to grow with the start-ups, we definitely invest in that start-up in the next round of their investment.

Moderator: Thank you. Our next question is from the line of Bhavesh Jain from Invagen Capital. Please go ahead.

Bhavesh Jain: Sir, do you see option to acquire 100% stake in Chhaya? And if yes, then what will be the valuation metrics for acquiring this balance 26% stake?

- Samir Khurana:** We have a firm commitment to acquire the balance 26% ownership of Chhaya. That 26% is to be acquired around November or December of next year and on a pre-agreed formula which was linked to the EBITDA performance of Chhaya for financial year 2018.
- Moderator:** Thank you. Our next question is from the line of Alekh Dalal from One-Thirty Capital. Please go ahead.
- Alekh Dalal:** What was your consolidated EBITDA for the fourth quarter?
- Saurabh Mittal:** Consolidated EBITDA for the fourth quarter or for the whole year?
- Alekh Dalal:** For the fourth quarter.
- Saurabh Mittal:** So, Alek, can you just give us a minute. Because we have given quarterly numbers probably standalone.
- Alekh Dalal:** And while you are looking for that, what was that growth on a year-on-year basis that you saw in last year's consolidated numbers including Chhaya, if that is possible to calculate?
- Saurabh Mittal:** Rs 256 crores for Q4 on consolidated basis. We had reported EBITDA loss of Rs 84 crores for nine months.
- Alekh Dalal:** And how is this Rs 256 compared to last year's on a consolidated basis, if you have that number, for Q4?
- Himanshu Gupta:** Alek, we do not have the Q4 numbers as of now. This is first reporting that we have done. Earlier we never used to report in the same format, so it will be difficult to give that number.
- Moderator:** Thank you. Our next question is from the line of Divesh Dokwal from Reliance Nippon Life Insurance. Please go ahead.
- Divesh Dokwal:** Sir, if you can throw some light on Chhaya numbers. What was the top line for FY17?
- Samir Khurana:** On a full year basis, the top line for Chhaya was around Rs 102 crores, but Chhaya had an impact on the top line because there was a change in accounting policy.
- Divesh Dokwal:** What was that?
- Samir Khurana:** Chhaya used to earlier book for sales returns on receipt basis and S. Chand has a policy of booking sales return on an accrual basis. So, in this particular year, they have done an accrual and receipt basis for Chhaya which has impacted the top line and the EBITDA by around Rs 2 crores - Rs 2.5 crores. And it has also been impacted by a Rs 14 crores shift in revenues from April to March which was also disclosed in DRHP. So, when we look at Chhaya on a normalized basis, for us we are looking at base line revenues of around Rs 118 crores.

- Divesh Dokwal:** And what is the guidance for FY18 for Chhaya?
- Himanshu Gupta:** So, Chhaya is looking to grow at around 15% to 16%.
- Divesh Dokwal:** And what is the debt on its books?
- Samir Khurana:** Chhaya is debt free; it has a surplus cash of around Rs 20 crores as on date.
- Moderator:** Thank you. Our next question is from the line of Anantha Narayan from Credit Suisse. Please go ahead.
- Anantha Narayan:** Sir, if you have this handy available, could you share what the operating cash flow for FY17 was net of working capital and taxes?
- Samir Khurana:** So, excluding the current assets that we acquired for Chhaya, because that also gets impacted in the free cash flows, I think we have a operating cash flow of around Rs 48 crores. I think if we adjust for this, the current asset that we acquired from Chhaya, it will probably be close to about Rs 55 crores odd.
- Moderator:** Thank you. Our next question is from the line of Nitesh Dhoot from Emkay Global. Please go ahead.
- Nitesh Dhoot:** Sir, so earlier you have mentioned that for procuring paper you normally enter into fixed price contracts for the entire year at one go during the beginning of the year. So, given that paper prices have been at elevated levels currently, so could you let me know as to what your average price for paper would be for the current year and percentage change last year?
- Himanshu Gupta:** So, basically as I said, when I met you last time, basically because paper prices have seen an exceptional growth over the last 12 months and we believe that as the company does, we are already in the final stages of negotiation with the paper mills and the dealers and we are almost on the verge of finalizing the paper. But, I believe the total paper impact this year in the company would be in the range of 15% to 16% increase of paper prices than last year. Last year, we procured paper at an average price of Rs 59 per kg; this year, we expect it around Rs 67 to Rs 68 per kg; so, around a Rs 9 to Rs 10 increase in paper prices over last year.
- Nitesh Dhoot:** And that would mean further pressure on your gross margin?
- Himanshu Gupta:** So, basically paper expense is 20% of the total company's net sales. Because normally paper increases 5% but, this year the increase is more than 15%; so, there is a differential of 10%. That means on 20%, there is a increase of 2%; so basically, we will also increase the prices of the books accordingly. Normally we increase the books prices by around 8% to 9% on an average, but this year we will be looking to increase the book prices by 10% to 12% and we

believe our operating margin or the EBITDA margin this year, as we will be in the range of 25% to 26% of EBITDA for the coming year.

Nitesh Dhoot: Alright. And sir, could you name a few paper mills from where you source your paper from, I mean if that is not a problem?

Himanshu Gupta: Sorry, we cannot disclose that.

Moderator: Thank you. Our next question is from the line of Alekh Dalal from One-Thirty Capital. Please go ahead.

Alekh Dalal: What were the one timers in the quarter?

Himanshu Gupta: One-time cost?

Alekh Dalal: Yes.

Samir Khurana: So, basically one-time costs were around Rs 3 crores in S. Chand, which is largely for the Chhaya transaction and some of the expenses which were incurred for IPO readiness, none of which is going to be repeated this year. On Chhaya, there is a Rs 2 crore impact because of a one-time impact due to change in accounting policy. So net-net, the EBITDA has been impacted by around Rs 5 crores odd because of one-time costs.

Alekh Dalal: Your guidance for next year, does that include any assumption if NCERT sells or whatever the Central Board says that you need to switch their text books to their own printed text books?

Himanshu Gupta: So, as per our knowledge, the whole CBSE or NCERT has not made it compulsory for the private schools to use NCERT books only, it is only in the media. But, as per the government, as per the CBSE there is no mandate to NCERT to publish for private schools and make it mandatory there, as of now.

Moderator: Thank you. We have the next question from the line of Nitesh Dhoot from Emkay Global. Please go ahead.

Nitesh Dhoot: Sir, could you please let me know the number of copies that have been sold in FY17 and the number of titles?

Himanshu Gupta: So, the number of titles that we have is the active titles, which is approximately 12,000. And, the number of copies at a gross level is now close to 50 million.

Nitesh Dhoot: Which compares to 35.5 million in FY16, right?

Himanshu Gupta: Yes.

- Himanshu Gupta:** I am telling you the gross numbers; the net numbers are slightly going to be lower. On a year-on-year the volume growth will be approximately by 5% to 6%.
- Saurabh Mittal:** These are gross numbers, net numbers will be lesser. So volume growth will be around 5% to 6%.
- Nitesh Dhoot:** 5% to 6%?
- Himanshu Gupta:** Yes.
- Nitesh Dhoot:** But the numbers that I have, I mean the numbers that you have given previously, 35.5 million copies in FY16; so, compared to that if you are saying only 5% to 6% volume growth which would not be in excess of 40 million in that case.
- Himanshu Gupta:** 35 million is excluding Chhaya, firstly. And secondly, the 50 million figure we gave is gross. So, there is also provision for returns that we do.
- Nitesh Dhoot:** No, what I meant is does this excludes, I mean the current number that you have given me includes Chhaya numbers and comparative number was not there for Chhaya, that is 35.5 million did not include Chhaya?
- Himanshu Gupta:** Yes, correct.
- Moderator:** Thank you. Ladies and Gentlemen, that was the last question. I now hand the conference over to the management for their closing comments.
- Himanshu Gupta:** So, thank you everyone for your questions. A very good afternoon, again, everyone. Thank you so much for this call. And if you have any questions we can take it later, or you can email us and we will be able to further assist you. And, you can email Samir Khurana – Head Strategy at skhurana@schandgroup.com, or our CFO Saurabh Mittal at smittal@schandgroup.com. Thank you.
- Moderator:** Thank you. Ladies and Gentlemen, on behalf of Axis Capital, we conclude today's conference. Thank you for joining us and you may now disconnect your lines. Thank you.