

“Uflex Limited Q2 FY20 Earnings Conference Call”

November 14, 2019

Conference Call Transcript

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Moderator: Ladies and gentlemen, good day and welcome to the Q2 FY20 Earnings Conference Call of Uflex Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an 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 Ms. Runjhun Jain from Nirmal Bang. Thank you and over to you ma'am.

Runjhun Jain: Thank you, Vivian. On behalf of Nirmal Bang, we would welcome you all to the quarter II FY20 earnings conference call of Uflex Limited. Today, we have with us Mr. Rajesh Bhatia, the group CFO and Mr. Rajesh Agrawal, VP, Investor Relations from the management team. I will hand over the call to Mr. Agrawal who will take the call from here. Over to you, Mr. Agrawal.

Rajesh Agrawal: Thank You Runjhun, Good evening everyone and welcome to second quarter FY20 earnings call of Uflex Ltd. On the call today, we have Mr. Rajesh Bhatia Group CFO, And other members of the senior management team. Before we begin, I would like to remind you that management will make forward-looking statements during the course of this call, and our actual results could differ materially. Uflex assumes no obligation to update any forward-looking statements or information which speaks as of the respective dates. I would now like to invite Mr. Bhatia to share some perspective with you with regard to company's operations and results for the quarter under review and after that, we will open the call to questions from analysts. Over to you, Mr. Bhatia.

Rajesh Bhatia: Thank you gentlemen for being on the call, very warm good afternoon to all of you.

To update you about the Q2, I think I can sum it up by saying that a steady quarter where the highlights of the quarter are slightly lower production and the sales volumes as well as the net revenue all in that proportion about 7% and that was caused by, because we closed our Dubai plant in the month of June for relocation to Russia, so we had only one plant operating in Dubai for this quarter and correspondingly, the production from the second plant was not available, so that is the shortfall which we have seen in the production, sales volume and net revenues this quarter, but despite that the margins have been better both in the overseas film business as well as in the packaging business.

In the India film business, the margins were bit lower as compared to the Q2 of last year but overall even at a lower number of production and sales volume, number of about 7% lower. The EBITDA was up about 5.4% for the quarter while the PAT was down by 1.8% because of higher incidents of the depreciation post commissioning of our holographic facility in Jammu. On a standalone level, the production and the sales number are pretty much constant, so the net revenue though decreased by about 7% on a standalone basis because I said that the domestic film business was affected in this quarter because of the prices being low but EBITDA was marginally up by about 0.3% this quarter again because while the films contribution was down, the packaging contribution made up for that and that is why at an EBITDA level, it didn't get affected and the EBITDA margin for the quarter were at about 14.9% on a consolidated basis which is quite heartening.

The commissioning of the projects in Hungary as well as in Nigeria is on schedule, so I think while we will see the Russia being commissioned in Q4 of this year probably towards the end of January or the beginning of February, the plants in Nigeria and Hungary will come in the Q2 of next year and FY21, we will see some of these plants operating and will add to our volumes of the packaging film business.

Overall, I say that decent performance and whatever is the lower number on the production sales as well as the revenue, it is all by design and not by any downward trend in the sales or anything else, so that pretty much sort of sums up the performance for this quarter and we saw in India business, in the BOPET, the gross margins being down by about 6% in Q2 and while in the BOPP, the margins were up about 18% over the last year number and international business, the EBITDA was up, 34% versus Q2, so all that translates into an overall EBITDA improvement of about 5.4% over the same period last year. I think that has been pretty much sort of the summary.

On the packaging business side, I said the volumes were constant but the profitability was higher over there because some of the low margin products we exited and that is why the overall volumes were static as compared to Q2 of last year as well as Q1 of this year, but yes, the volumes have moved to higher margin business and some of the low margin business we have deliberately exited and as we go forward, the endeavour is to focus more on the export of the packaging product as well as domestically we are also looking to go up the value chain. Another notable thing which happened in this quarter and everybody was after the Prime Minister announced on 15th of August that there will be some kind of harsher treatment for the single used plastics, I think everybody got a bit worried. While at Uflex, we are not into any category of single use plastic and it didn't affect us but as an industry leader, we have taken the initiative, we have taken the lead in terms of interacting with government as well as the other stakeholders to put forward the arguments and the case that it is not a situation which calls for some drastic things like this. All these things are pretty manageable.

I think we could use our existing facilities for recycling at all our plants to showcase that if whatever is the plastic waste at all of these plants, if that is being recycled, then the waste which is collected from the public also by the municipal corporations today, that can also be sorted and recycled. The only additional step there being the sorting because that is the mixed waste and you can't really segregate when the waste is collected from households or any other places as to whether it is plastic or glass or metal or cloth or food, so you have to set it up a garbage sorting facility and from that sorting facilities, whatever is the plastic recycling, waste plastic that you get you can recycle this, so I think we have been able to demonstrate that to very good extent and we are doing it all this through industry forums and we are working at setting up the pilot plant, may be one or two in the next 6 months' time which will showcase, so today whatever we are able to demonstrate is confined to our own internal facilities and the plants but this will be opened to the whole world to see that how the garbage is sorted and then the sorted garbage out of that whatever is the plastic waste, how we are able to recycle that and make various products of plastic, be it any plastic products like benches, stools, buckets, mugs, road dividers or any other articles of plastic, there may be more than 10,000

items of plastic which can be made using this and I think that is what we are going to showcase, the industry is going to showcase and we providing leadership. They are in terms of demonstrating that this is what should be the logical steps rather than thinking of curtailing use of plastic because it is a boon material and today, if we are able to control on our food wastages or other wastages, it is only because the plastic is being used to packaged food, so it is increasing the performance. It is not something which is single use plastic like cutlery or the plastic bags, they are performance enhancing packaging without which there will be lot more food wastages, there may be as if the farmers are not able to or other intermediaries are not able to store the food articles, so the things may turn pretty bad in terms of the distress.

And if we go to any alternate uses like paper and all that, so they also serve a limited purpose only and end of the day, they are also environment unfriendly and that is where from the paper the word moved over to plastics many years ago and now if you are talking of coming back to the paper, so that is a retrograde step rather than an accretive step and that has its own challenges in terms of the environment unfriendly as well as, yes that is self destructing on its own but eventually at the end of the day, you need to see the pros and cons of moving onto the paper which is simply not possible, so the problem does not lie in the plastic, the problem lies in the way the plastic waste is being handled today and yes, there will be some investment on the part of the government or on the part of the municipal bodies to sort on the garbage and to sell the various sorted material out of the garbage to the various recyclers but that can be compensated by way of some additional cost which will ultimately be borne by the consumer but that will solve the way the plastic will be recycled and we also demonstrated that apart from this recycling thrust, the government also needs to make the whole plastic biodegradable because yes, there will be still some plastic left which won't be collected, so that also has to eventually, if the plastic is biodegradable that will eventually be converted into the biomass at the end of its designated life cycle, so if we make the plastic biodegradable mandatorily make it biodegradable also. Then even if we all throw something, polythene bag or some chips packet or some bottles road side or beach side and all that so that will be turned into fertilizer at the end of the designated life cycle. So if we do these two steps then all the noise about what we are hearing about plastics will be addressed and that is the way to go.

I think once this facility, these pilot plants come up that will be the real demonstration of us to how the government takes any further steps on the plastic issue, yes they have said that by 2022, we shifted the target to 2022 but I think if we are able to demonstrate that well, so then we have a pretty good case and we even had some of the people visiting our plants and seeing with their own eyes and they were in a sort of awe and disbelief that these are the things what are already happening and they clearly saw that the plastic waste which is generated at the plant being recycled into some of the alternate plastic products, so I think the messages have gone well. Next 6 months or so after we demonstrate on a public platform that this is all achievable, I think then we will see as to what further, the government's thought process is on the way to handle the plastics.

I think here, what we are also saying is here because it is being done by a Indian company and no other company is worldwide recycling its plastic waste, so India could take the lead and become the first nation to say that we have a solution for the plastics, not only for the plastic industry over here but even for the government, it will be a good thing to say and declare to the world that India has a solution to the plastics, the plastic waste being handled and being recycled and being biodegradable. So I think while 2nd October, there is nothing which was the deadline for the government to announce something on the plastics, there is nothing that came out and the government said that it was more of an advisory rather than any ban that they had contemplated but I think in the right earnest, we are taking that and we are trying to showcase that look. This is how the problem has to be handled and we pretty sure that this is the way it will emerge over the next few years. So that is it from me in terms of briefing all of you about the Q2 and what is happening around us in the industry.

We are open to any questions now and I will be to glad to address that.

Moderator: Thank you very much sir. Ladies and gentlemen, we will now begin and question and answer session. We have the first question from the line of Jiten Parmar from Aurum Capital. Please go ahead.

Jiten Parmar: I have a few questions, one is if you throw some light on where Asepto is, what is the situation and what is the capacity utilization, are we EBITDA positive on it next quarter and also on the engineering business?

Rajesh Bhatia: I think Asepto, yes, we had good beginning to the season which starts with Q1 and Q1, our volumes were obviously larger, Q2 generally takes a bit of a lean period but Q2, over the last year Q2 we still had 150% the volumes increased but notably what is good is that there are one or two large companies which I will not be able to name it because of the confidentiality reasons but they are on board now and we will see in the next one or two quarters that the volumes will go up dramatically on the Aseptic packaging. We were EBITDA negative in this quarter on the Aseptic packaging. Last quarter, we were EBITDA positive on the Aseptic packaging, so overall for the year as a whole, though we are more or less evened out, so with the minus there in the second quarter and with the plus there in the first quarter of this fiscal. I think we are more or less at a neutral position if we take the H1 into account, but as I said that one or two major accounts that we have cracked and there the orders have already started kicking in, I think will show and they are not small, they are large accounts and that will really pave the way for the capacity utilization. We can safely assume that by the first quarter of the next fiscal, we should be ready to order another printing line which will sort of take or which will double our capacity because as of now, we have limited our investment over there and we will obviously take that call as and when we reach to about 75% capacity level.

Jiten Parmar: So what would that CAPEX be, Q1, is it around...

Rajesh Bhatia: 50 crores.

- Jiten Parmar:** Sir, engineering also had lower volumes or basically lower revenues, any light on that?
- Rajesh Bhatia:** Engineering business is a bit of business which keeps on, there is high degree of the variability there and that really depends on the order book and all, so that is the natural cycle of that business and when you have larger orders, so I think some of the Asepto packaging machines where we have been working, so I think we need to deliver those and even if two machines would have delivered in the last quarter, we would have made up for that loss but unfortunately we could only deliver them in the next quarter as it happens in some of these engineering or the infra businesses, so the business is sort of normal but sometimes you have the quarterly fluctuations coming your way, so I don't see much sort of issue over there.
- Jiten Parmar:** My next questions are basically what is the consolidated debt as of now and any debt reduction plans? Next is CAPEX for the remainder of this year as well as next year?
- Rajesh Bhatia:** I think in India, balance sheet we have from March to this now, we have about 150 crores already come down. In the overseas, we have two projects currently where we have to spend about 140 million plus another 35 million on the Russia project, so that much of the debt will come on the balance sheet minus the equity that we have to contribute to these projects and given that there are sufficient internal accruals, but still we will see that the debt would be added, so we can take the total CAPEX size for Russia, Hungary and Nigeria at about 175 million for which they will be debt added and the revenues and EBITDA will follow over the next one year or so.
- Jiten Parmar:** What I want to know is, what would be our peak that before it starts deleveraging or something, is that number we have worked out?
- Rajesh Bhatia:** India has already started deleveraging and as I said that in the H1, there is a reduction of about 150 crores. For overseas, debt if I see as on 31st of March, the long-term debt was only \$40 million in the overseas business which was sort of getting repaid, most of it was getting repaid in the next 3 years and this new debt which now gets rid of obviously will take about, it is only that the new debt which gets added on and the existing debts keep on paying. The overseas business given that today it generates an EBITDA of about, last year it did about \$80 million with a long-term outstanding debt of \$40 million only. It can handle all, even if the 40 gets repaid and the new debt say, \$150 million, so we know it is still a very manageable number for the overall debt position for us.
- Jiten Parmar:** And last question, what are the spreads, for BOPET, I think last quarter was around 45 or 50 if I may and currently?
- Rajesh Bhatia:** So BOPET prices for the Q2 margins were about 6% lower as compared to Q2 of last year in the BOPET while in the BOPP, the Q2 margins were 18% higher as compared to the last year.

- Jiten Parmar:** Yes, basically what I am understanding is and what I am saying is basically BOPP margins have been an uptrend and BOPET has been?
- Rajesh Bhatia:** Because BOPP really touched its low in the Q1 and Q2 of the last year, so coming from there the margins have gradually improved as the excess capacity keeps on getting absorbed.
- Jiten Parmar:** So currently we have no plans of adding any lines in India for?
- Rajesh Bhatia:** No, we are not adding any lines in India.
- Moderator:** Thank you. The next question is from the line of Rajendra Shah, an individual investor. Please go ahead.
- Rajendra Shah:** I would like to know why our standalone margin is very low compared to the consolidated margins and second thing that our debt has remained very high in the industry if I compare with the other balance sheet of the same?
- Rajesh Bhatia:** I will tell you the standalone EBITDA margin for us is about 12.5% this quarter which was 11.5% in the last quarter. I am talking EBITDA only because others are just a function of a number, so really the earning level is determined at an EBITDA level, so it is about 12.5% in this quarter as compared to 11.5% last quarter. This is standalone, while the consolidated basis, it is about 14.9% this quarter as compared to 13%.
- Moderator:** The next question is from the line of Dnyanada Vaidya from Nirmal Bang Securities. Please go ahead.
- Dnyanada Vaidya:** Sir, Q2 has declined in both sales volumes and production because the line was shifted from Dubai to Russia, so sir Q3 will also see a decline in volumes because of the shift?
- Rajesh Bhatia:** I have said that we will see the similar decline in the next quarter also because that line will get commissioned in the Q4 of the fiscal FY20 only.
- Dnyanada Vaidya:** So what is the capacity of that line that is coming up in Russia?
- Rajesh Bhatia:** That is about 2000 tonnes per month.
- Dnyanada Vaidya:** And sir the one in Dubai, is it the same capacity or is there any...?
- Rajesh Bhatia:** The one in Dubai is a little lower capacity.

- Dnyanada Vaidya:** Sir, the gross margins, I mean the EBITDA has significantly increased in this quarter, so is it totally because of packaging margins going up or is there any other reason to it because the sales have come down by about 7% Y-o-Y?
- Rajesh Bhatia:** So it is only because the better margins in the packaging business and better margins in the overseas films business also.
- Dnyanada Vaidya:** And could you quantify the gross BOPET margins in India, they were 45 I think in the previous quarter?
- Rajesh Bhatia:** So the BOPET margins this quarter were about, last year they were about Rs. 55, this year they are about Rs. 49.
- Dnyanada Vaidya:** Sir and with these two new BOPET lines coming up, how do you see these margins panning out in the later H2?
- Rajesh Bhatia:** I think while the one line has already been commissioned and Jindal line has already been commissioned and that is where I said that Q2 of last year versus Q2 of this year we have seen in the BOPET industry a reduction of about 6% in the gross margins, so I think that has more or less been taken care of and I think January onwards we will see better margins coming to the BOPET industry again.
- Dnyanada Vaidya:** So more than 49?
- Rajesh Bhatia:** Yes.
- Dnyanada Vaidya:** More than 49 per kg?
- Rajesh Bhatia:** I think let us say for northwards of 50, whatever it is.
- Dnyanada Vaidya:** Sir the next question is, sir the employee cost in this quarter has been significantly lower on a sequential basis, it was 189 approximately crores in Q1, so was there any one-off there or? Q1 FY20?
- Rajesh Bhatia:** Q1 FY20 was higher you are saying?
- Dnyanada Vaidya:** Yes sir. It was about 189 crores.
- Rajesh Bhatia:** May be because of some the bonus and all that coming in the first quarter and all that so that may be the reason.
- Dnyanada Vaidya:** And the capital work in progress has significantly increased in this quarter, so is it because of the Nigeria and Hungary investment?

- Rajesh Bhatia:** Nigeria, Hungary, Russia and we are also looking at some small investments on the PCR side, the post-consumer recycle, PET bottles we are now recycling to, we are using that recycle chips to make BOPET films in our US plant and we are using that up to 90%, minimum 90% we are using and that has given us good margins in the US, so the US margins in the H1 had been higher, so the plan is to use it, increase it over the period, but today what we are doing is, we are buying the PCR chips from the market but today we need to showcase that one, there is a commercial sense in sort of setting up a facility where you get the PET bottles and you recycle them to make the chips, one commercially it is lot more viable today. Secondly that also helps you in recycling and making film from a recycle polymer, so that has been the endeavour that buoyed by the success of that in our US facility which is now also certified by the SES global also, so we are looking at some small investments coming up to set up those PCR facilities where we will get the PET bottles and recycle them to make the chips which will be used to make the BOPET films again. Only the BOPET films can be made using the recycle PET bottle chips and BOPP you can't sort of do that. So I think this will help us both commercially as well as from environment standpoint view where the polyester film that we make is already made from a recycled material.
- Dnyanada Vaidya:** Sir, last few questions, sir the project that you mentioned about the pilot project, so what would be the approximate CAPEX for that and is it in partnership with the government or?
- Rajesh Bhatia:** No, it will not be partnership with the government, but I think the industry for the packaging film industry association will all sort of make contributions towards this. I think it should not be about more than 4-5 crores for each company.
- Moderator:** Thank you. The next question is from the line of Raj Koradia from Edelweiss. Please go ahead.
- Shradha:** Hello Mr. Bhatia, Shradha here. Just wanted to understand this volume that we have put up in the press release that is all the three divisions put together, right, I mean international, domestic, films as well as packaging, right?
- Rajesh Bhatia:** Yes.
- Shradha:** And secondly, wanted to understand while domestically you mentioned that the gross margins were down in BOPET and BOPP it was up, but what led to the sharp jump in international EBITDA, you said international EBITDA was up, some 34%?
- Rajesh Bhatia:** So again number one, the prices for the BOPET as well as the BOPP, number two, the value add which as I said in our US facility we had higher value added, these PCR based films which obviously gives us a better margin, so I think both the pricing side and as we have been saying largely that except the Mexico plant, all other plants and today fully sold out, so obviously once that sort of a situation comes, you turn to take, you can't have more supplies than what your capacities are, so obviously in that what happens is that there are customers where the prices or the margins are low,

so they normally get weeded out as a natural process and all that and you definitely have better margins going down the line but once your new capacities will come up, so obviously now you are looking to gain more market share, so there you will have the margins coming to a bit of a normal.

Shradha: Sir, what is the profit per kg the way you explained for BOPET from 55 to 49, similarly how is it internationally?

Rajesh Bhatia: Internationally, I don't have separate numbers but internationally, our EBITDA margin this year was about 18% of all the businesses put together, 18% EBITDA margin.

Shradha: Sir, what I wanted to know is, internationally the per kg is up year-on-year?

Rajesh Bhatia: It is up.

Shradha: And BOPET as well, right?

Rajesh Bhatia: Yes, last year was about 15%.

Shradha: So internationally we are not seeing the pressure of the new capacity that was only in India?

Rajesh Bhatia: Yes, that was only in India.

Shradha: And just one more question on this working capital where we are seeing big increase in the loans and other financial assets, so what is this led by? There was almost I think 187 crores increase.

Rajesh Bhatia: I think they would be; I think largely the advances for the CAPEX given where they are only sort of either the advances to the contractors or advances to the machine suppliers which are still not delivered. So as we speak today, I think there are advances given or LCs established for Nigeria as well as Hungary, so all advances which are paid would figure in that loans and advances increment.

Shradha: And just lastly one more question on volume, I just wanted to know how much was the half year packaging volume? Was that also, you said it was flat or was it declining?

Rajesh Bhatia: So the packaging is about 21,000 tonnes.

Shradha: For the quarter?

Rajesh Bhatia: For the quarter and that is what we have been doing now for the last 3 quarters or so, so that is around the number we have been.

Shradha: So is that flat or that is declining because we are reducing the lower margin product?

Rajesh Bhatia: I think it is largely flat.

Moderator: Thank you. The next question is from the line of Aman Sonthalia from AK Securities. Please go ahead.

Aman Sonthalia: Sir, my question is that I had seen the management commentary of SRF, they are saying that there will be some overcapacity in the BOPET business for the next 1-1.5 years, so how do you see the prospect of that business in the overseas?

Rajesh Bhatia: I see that in the next 2 years' time there is one line which is coming which will come in Q4 of this year, so that may cause some effect but generally Diwali and around becomes sort of low season business for us or for the packaging film industry but this year we have not seen that happening, so I think may be because people were too scared around the 2nd October deadline as to what will happen, so people were already carrying very low stocks and all that so we didn't see that the demand going down and the prices from November have rather improved, so we expect when that line will come there may be some time for which the margins may come under pressure but we believe that in about a quarter's time that will not be lasting and may be there for a quarter or so. That is all.

Aman Sonthalia: Sir, they are talking about the outside India margins?

Rajesh Bhatia: Outside India, SRF operates in a different territory so they are in Thailand and all these places while we are not there, so I wouldn't have really much idea about.

Aman Sonthalia: Sir in our market, they don't see any such reduction in margin?

Rajesh Bhatia: No, we don't see anything happening over the next 1 year or so.

Aman Sonthalia: And sir, how much capacity utilization can you expect by the end of the fourth quarter?

Rajesh Bhatia: For which product?

Aman Sonthalia: Asepto?

Rajesh Bhatia: Asepto, I think my Asepto business team tells me that they will achieve 70% to be minimum.

Moderator: Thank you. We have a following question from the line of Dnyanada Vaidya from Nirmal Bang Securities. Please go ahead.

Dnyanada Vaidya: Sir, I just wanted to know how many customers we currently serve in the Aseptic packaging business?

Rajesh Bhatia: I think we serve about 30 customers or so?

- Dnyanada Vaidya:** Sir, last quarter I think the figure was about 65?
- Rajesh Bhatia:** I may be wrong here, but I think we will need to then handle that offline.
- Dnyanada Vaidya:** Sir, could you please give me the breakup of the international business in terms of BOPP and BOPET because the BOPET prices are going up and the international business has reported good margin?
- Rajesh Bhatia:** Internationally, we have all BOPET facilities only except one line in Egypt which is BOPP line, so accepting one line where the capacity could be 30,000 tonnes a year, rest is all BOPET facilities for us.
- Dnyanada Vaidya:** So why are the margins going up, why the facility is only in Egypt, I mean the BOPP line is only in Egypt and the rest are BOPET, so if BOPET has not seen any margin improvement, why are the international business margins inching up?
- Rajesh Bhatia:** So international business margins are definitely better this better, I said that. I didn't say that international business margins are under any sort of a pressure, so international business margins on the BOPET as well as on the BOPP side have been better in this quarter.
- Dnyanada Vaidya:** Sir, if there is one more line that is coming up in Q4, the Jindal line is already commissioned if there is one more line, so why do you seen an improvement from Jan in the margin. There will be more supply than probably the demand?
- Rajesh Bhatia:** I think that is already taken care of and we had seen the prices coming off as compared to last year by about 10% or so already and one line only coming, if we see FY19 prices and the Q2 prices, so they will be off by about 7 to 8% or so, so I don't see that one line adding would create that much of ripple effect as we go forward. By the time the Jindal line which came would have also sort of stabilized and would have also had volumes and all these new lines also which come, it takes time for us to come to a certain capacity utilization levels and all that so I don't really think that there can be any further sort of huge downside on the BOPET margins, but let us see when we go to when that line gets commissioned and as I said that, normally Diwali and around that period, normally the offtakes are low, the prices are less and all that but despite that Jindal facility coming into production earlier this quarter, the prices have only improved in the month of November.
- Moderator:** Thank you. Ladies and gentlemen that was the last question. I now hand the conference over to Mr. Rajesh Agrawal for closing comments.
- Rajesh Agrawal:** Thank you everyone for joining us today and we look forward to staying in touch in future quarter. Thank you again.

Moderator: Thank you. On behalf of Uflex Limited that concludes this conference. Thank you for joining us, you may now disconnect your lines.