



“Tube Investments Q2 FY19 Earnings Conference Call”

November 05, 2018



MANAGEMENT: MR. VELLAYAN SUBBIAH – MANAGING DIRECTOR
MR. MAHENDRA KUMAR – CHIEF FINANCIAL OFFICER
MODERATOR: MR. KASHYAP PUJARA – AXIS CAPITAL LIMITED



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Moderator

Ladies and Gentlemen, Good Day and Welcome to the Tube Investments Q2 FY19 Earnings Conference Call, hosted by Axis Capital 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 call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Kashyap Pujara from Axis Capital Limited. Thank you and over to you, sir.

Kashyap Pujara:

Thank you so much. Good morning, everyone. And thank you for standing by. It is a great pleasure to have with us the management of Tube Investments Limited for Q2 FY19 Earnings Call. From the management side we are represented by Mr. Vellayan, who is the MD; and Mr. Mahendra Kumar, who is the CFO. Without taking too much time, I now hand over the floor to Mr. Vellayan. Over to you, sir.

Vellayan Subbiah:

Thanks you, Kashyap. Good morning, everybody. I will just go through quickly the first quarter performance highlights, and then turn it over to the audience for questions.

Basically it has been a pretty good quarter for us. Like you know, and we spoke about it a bit on the last call, we have identified the four key areas that would be the focus areas for the company, which are: revenue growth, profitability, return on capital employed, and free-cash-flow. And we have done, I think, in the first half and in the quarter as well, pretty decently around those four dimensions.

We have had the highest ever revenue of Rs. 1,370 crores, which is a 17% growth over Q2 of last year. I think the market conditions have definitely helped us in that perspective. The first half has seen Rs. 2,700 crores in revenue, which has been an 18% growth over the same time last year.

PBT growth has been at 18% over the quarter last year, we had a PBT of Rs. 85 crores, which is also our highest ever PBT. And for the first half year before, exceptional items, we were at Rs. 164 crores, which is a growth of 38% over H1 of last year.

Our return on capital employed to 20%, which is quite encouraging, because definitely that has been a key area for us and we have to push that number significantly up from here.

And finally, free-cash-flow to PAT was at 54% for first half, and we definitely would like see that number improve as well as we finish out this year. At a quarterly level, basically this next quarter tends to be the toughest quarter to manage free-cash-flow, but after that, we have a fairly strong focus on it.



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And so in the first half we basically generated free-cash-flow of Rs. 60 crores and the key attribute, obviously, was the higher profitability and lower capital employed, which allowed our return on capital employed to improve.

In brief, on each of the businesses, the cycles business is where we continue to have the biggest challenges. And our trade volumes dropped by 4% during this quarter compared to the previous year. And division registered a revenue drop of 13% compared to same quarter of last year. That is mainly because of deferral of institutional sales, which traditionally happen in the first half, but this year, have gotten shifted to the second half. So, PBIT for the quarter was at Rs. 5 crores against Rs. 9 crores for the corresponding quarter of last year.

The engineering business, on the other hand, has had a very good quarter, and a very good first half. Both the domestic and export businesses have grown significantly, and that has registered a volume growth of 18% in tubes compared with corresponding quarter of the previous year. The large dia plant, which was our latest capital expenditure in that area, also recorded a volume growth of 41% and has become profitable.

The revenue for the quarter for engineering was at Rs. 776 crores, compared with Rs. 570 crores in the same quarter of last year, which is a growth of 36%. And PBIT was at Rs. 65 crores as against Rs. 45 crores in the corresponding quarter. So, for H1 ROCE for this division improved to 37% as against 25% of the corresponding period last year.

Metal form products, which is our door frames and our railways business, grew by 14%. Chains and kits grew by 13% and 16% respectively over the corresponding quarter of last year. And revenue for the quarter was Rs. 338 crores compared with Rs. 287 crores in the corresponding quarter of last year, which was a growth of 17%. PBIT was at Rs. 31 crores versus Rs. 26 crores, and ROCE improved to 27% versus 23% in the first half last year.

At a consolidated level revenues were higher by 17% at Rs. 1,495 crores as against Rs. 1,284 crores. And PAT was at Rs. 67 crores as against Rs. 44 crores in the corresponding quarter of last year. And Shanthi Gears, our subsidiary, registered revenue of Rs. 59 crores during the quarter as against Rs. 54 crores, and a growth of 9%. PAT was Rs. 9 crores versus Rs. 7 crores in the corresponding quarter of last year.

So, that is just a brief on the performance. And I will stop with that and turn it over to all of you for questions. Thank you.

Modertor:

Thank you very much. We will now begin the question-and-answer session. Our first question is from the line of Anupam Goswami from Stewart & Mackertich. Please go ahead.



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- Anupam Goswami:** My first question is, on the metal forming products what percentage of revenue comes from the railways?
- Mahendra Kumar:** It is about 5% of metal formed products' revenue.
- Anupam Goswami:** And the rest from your passenger vehicles I believe?
- Mahendra Kumar:** Yes mainly PVs and two wheelers.
- Anupam Goswami:** On that note, sir, what is your view on the passenger vehicle numbers, we are seeing the growth has subdued going ahead. So, what is your conclusion on that?
- Vellayan Subbiah:** ~~So, just to give you an essence, the rest is from passenger vehicles, because a large chunk of it also comes from the two-wheeler business, which still continues to be very strong for us. And, obviously,~~ a lot of people are concerned about PV softening, but we have a fairly large dependence on one customer and that customer's performance still continues to be very strong as far as the metal form products on the four-wheeler PV side is concerned.
- Anupam Goswami:** And, on the Shanthi Gears performance, what is your subsidiary's current orders and what is approval, if you can share?
- Vellayan Subbiah:** Sure. We will be able to get to you, are our order book has built up significantly and is at its strongest point ever, right now. So, it is definitely very strong from that perspective. And like we said in terms of the results, we are still fairly bullish there in terms of what we see as growth opportunity. There, our real focus is on manufacturing and productivity improvement, because we have got a strong order book, so we are looking at ways in which we can quicken the fulfillment of those orders and reduce the turnaround cycle there. So, that is a key focus for that business.
- Mahendra Kumar:** ~~If you want to know the total order book on hand,~~ we had about Rs. 150 crores of order book on hand as of September end. And during Q2 we took about Rs. 74 crores worth of orders.
- Anupam Goswami:** And lastly, if you can give some guidance on Tube Investment, what kind of revenue and EBITDA margins we are currently looking in FY19 and going forward?
- Vellayan Subbiah:** So, I think, we talked about that a bit last time which is, over two to three-year horizon we would like to push PBT to 10% of sales or double-digit levels. And that we see happening over a two to three-year timeframe. And growth, I would say, in that range of about 17%.
- Anupam Goswami:** Sir, your cycles volume has dropped, you mentioned. I kind of missed the reason that you have given, can you just share it again?



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- Vellayan Subbiah:** Cycles, obviously the cycles business the standards are not growing, industry wide. And what we are seeing is on the special side we are seeing price competition come in, especially from one or two of the larger players. And them using price much more is a weapon to gain market share. So, basically, that is what has cost us in this quarter, and we are looking at how to improve both from efficiency perspective and see what we can do to maintain or slightly increase our market share in the special segment as we go forward.
- Anupam Goswami:** What kind of market share do we currently hold, any ballpark number?
- Vellayan Subbiah:** So, we hold close to 27%. It depends ~~on the segment, right, it depends~~ on what segments you include in it.
- Modertor:** Thank you. Our next question is from the line of Sanjay Jha from KSA Shares and Securities. Please go ahead.
- Sanjay Shah:** Sir, we have been doing much better on our engineering side since last two quarters. Can you run up through the optimism about that, and how we are able to achieve the better margins and business? And what is the visibility ahead?
- Vellayan Subbiah:** So, obviously, the engineering business has been doing well across three or four different segments. The first is that the business invested a lot in terms of beginning to increase the level of exports in the business. And we have seen that really help us grow both in the ERW segment and the CDW segment, exports have been up significantly. And that is through a lot of effort in investments that the team has put in growing that part of the business. So, that has been the first big driver for growth. And do we see that as sustainable? Absolutely. Because a lot of this has been done despite the fact that the US is pretty much shutdown. So, all of our exports are going to Asia and Europe. So, that is the first big growth driver. Second is, now the large dia plant started firing on all cylinders and has increased its utilization significantly. On the CDW side it is at 100% utilization and that creates a good opportunity for growth from that point as well. And so that we see continuing. And we are very encouraged by that business and the growth offered by that business as well. On the home side also we basically see, when we look at the domestic business we have seen fairly good growth on the CDW side of that business. So, that is fairly encouraging. And then finally the cold rolled steel strips have been stable, not a whole lot of growth, but we are seeing opportunity to improve that business as well as we go forward.
- Sanjay Shah:** Sir, what is the percentage of export in engineering?
- Vellayan Subbiah:** Percentage export, you are talking from a volume perspective?
- Sanjay Shah:** Yes.



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Mahendra Kumar: Would be around 13% in value terms

Sanjay Shah: So, this time did currency help us or actually volume has helped us?

Vellayan Subbiah: What was the volume last year, Mahendra?

Mahendra Kumar: Volume has moved up.

Vellayan Subbiah: Mr. Shah, to your question, the volume has moved up from last year, we will give you the number what it was.

Mahendra Kumar : So, we did about 58,000 tons in tubes this time compared to about 49,000 tons last time.

Mahendra Kumar: Exports alone had about 26% growth in Q2 alone.

Sanjay Shah: And that was 13%, right?

Mahendra Kumar: Around 13% in value terms.

Sanjay Shah: And sir now coming back to Shanthi Gear, can you run us through the future of Shanthi Gear? Because we have not been able to ramp up, and as you said that you are optimistic, but I have seen that we have been compromising on the margin side with growth. Can you elaborate on that, sir?

Vellayan Subbiah: Definitely. In Shanthi margins are under pressure currently, especially because raw material prices have been increasing on the steel side significantly at Shanthi. And the potential to pass that through is definitely less than Shanthi. So, we are seeing margin compression happen from that perspective. So, the only way to improve performance at Shanthi has to be from productivity in-house in the factories, which is the effort we are focused on now. It will take more time to come to fruition, so I don't think you can expect immediate change or any sudden jump in Shanthi's performance, because still we can figure out how we improve productivity significantly, there is not much option to increase revenues beyond the levels we are increasing them at the current stage.

Sanjay Shah: Sir, that is production bottleneck or even technology wise we are not able to push our products?

Vellayan Subbiah: It is a production issue, it is not a technology issue.

Sanjay Shah: So, technology wise we are at par?



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Vellayan Subbiah: Technology wise Shanthi is always and continues to be seen as the real leader in this space. So, I would say, we are better than the others from a technology perspective.

Sanjay Shah: And sir what capacity currently we are running, Shanthi Gears?

Vellayan Subbiah: So, Shanthi is a difficult place to define capacity, because it is a very complex production process, it is much more bespoke in nature. But, in our key businesses that is a challenge we are having today that, like when we take Helical and gear and pinion, we are running pretty much flat out today.

Modertor: Thank you. Our next question is from the line of Mr. Kashyap Pujara from Axis Capital. Please go ahead.

Kashyap Pujara: I had a couple of questions. My question was mainly on the gross margins, so if I see the overall operating performance you have definitely improved significantly on a YoY basis and we are seeing good amount of operating leverage across all costs. But when I see gross margins, we are still lower on the gross margin front on a YoY basis. So, could you basically just run us through whatever thoughts on gross margin? And overtime what is the kind of improvement you see? Because the 10% PBT goal that you have set for yourselves would also basically be driven by some amount of gross margin expansion.

Vellayan Subbiah: Yes. So, again, Kashyap, the question absolutely is a very valid one. And if you come back, last time we had articulated the main drivers that would help us in this path to PBT to sales improvement. And those drivers were revenue enhancement predominantly through mix and more effective mix of product. Then there were a set of sourcing initiatives, higher scrap realization, logistics cost, finance cost, fixed cost, quality material related cost and other variable cost. So, if you see what is happening overall for the gross margins right now, there are certain of these levers that we can pull in the short term and some of these levers take more time to implement. So, the levers that are happening in the short-term, the ones that we can get are basically scrap, logistics, something on the finance related side and we can look at things on the fixed cost. When we think of things that affect gross margins, one of the big drivers for it obviously is what we can do with mix and how we produce some of the products that we produce. And that is going to take longer, for example, the earlier question on exports, unless we have a larger shift towards exports, we do not see that. And second thing is, for the last two quarters we have had a significant impact from steel, steel which is most of our raw material, our single largest buy has significantly gone up in the last two quarters. And this has been a big challenge for us as well. Now, definitely we see steel as a cycle, but one of the things we have to look at is how we can reduce the impact of rising steel cycles in our overall pricing, and we are looking at that significantly as well. Kashyap, I don't know if that answers your question on gross margins.



Kashyap Pujara:

I understand the direction. Second question was on the cycle division, while you do mention that there are challenges and it will be a process to fix it over the next couple of years. But what was encouraging this quarter was the sharp drop in capital employed in this business. And I remember the days when the capital employed in this business was not more than Rs. 100 crores on a fixed and working capital both put together. So, do we read this as a trend that capital employed in this business will shrink from here-on, while you work on enhancing revenue from there over time, I mean, how do we read it?

Vellayan Subbiah:

It is a good question. So, first, we break it down, definitely on the fixed capital side there is no need to add any fixed capital to that business. We have got adequate capacity between both our plants, as a matter of fact, more capacity than we need between both our plants. And high end cycles are imported and we have adequate capacity on that front as well. So, there is no capacity challenge and there is no fixed capital required as far as that is concerned. In terms of working capital, we have got obviously two different sets of businesses, one on the trade and retail side and the second on the institutional side. The institutional side tends to employ more working capital, so this is something that we have to look at and optimize over time. This year, Kashyap, the bad news is that in this quarter you will see the working capital go up because of the institutional side. But we are looking at what can be a more permanent solution for us, which we wouldn't be able to implement this year but we will definitely have in place by next year to reduce the overall working capital. So, the broad answer to your question is, yes, which is we are looking at ways to manage the capital employed in the cycle business and push that number significantly down. Will we able to do it all this year? The likely answer to that is, no. So, we will see this quarter having a spike in working capital in the cycles business, but we see it being resolved as we go into next year.

Modertor:

Thank you. Our next question is from the line of Meet Jain from Prithvi Finmart. Please go ahead.

Meet Jain:

My one question is regarding the engineering segment. As you have seen that our EBIT margins have not grown as compared to the last quarter. So, what was the main reason behind that? Our revenue has grown but the margin has been same.

Vellayan Subbiah:

So, again, I think obviously the biggest driver, and I am just pulling up the engineering numbers, but the biggest challenge obviously we have is rising steel prices. And that affects that segment significantly because steel is such a huge percentage of overall raw materials there.

Mahendra Kumar:

Compared to Q2 of last year there was a marginal improvement in EBITDA margins, I think you are comparing with Q1 of this year.

Meet Jain:

In Q1 our EBIT was round 9% for the engineering segment, and currently it is around 8%.



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Mahendra Kumar: You are talking about EBIT percentage?

Meet Jain: Yes.

Vellayan Subbiah: You are right, for the quarter it has not improved, quarter-on-quarter it has not. But I think it is difficult business to manage quarter-on-quarter. The biggest issue that affects EBIT is clearly the steel pricing. And steel pricing end-up having some factor that go across quarters as well, because in some cases we have to try and get price recovery. In some cases, the increase does not fully hit us in that same quarter itself, depending on how we inventorise. So, the steel pricing can swing from one quarter to the next, and that creates a significant swing in EBITDA. So, I think it is a better trend to look at what is happening, if you take it at an annual level it is a better way to look at EBITDA for that business. So, first off, in years where you see a rising steel cycle there will be pressure on EBITDA. But we have to look at it in terms of what we can do over the entire cycle, and that is what we believe can improve performance on.

Mahendra Kumar: And when we recover, we always recover with retro effect, so there is no loss of margin here, just a matter of shift between quarters.

Meet Jain: And on the cycle side, as we have seen that cycle business has been not performing well, so what exactly the management's going forward plan would be to revive that business?

Vellayan Subbiah: So, I think I talked about it last time as well, right. The first thing is just a very strong operational focus, both on the sales side and the manufacturing side. The sales side, obviously, what we can do to increase market share, both through our own stores but also through the channel. And that is a combination of new product, and getting the product to the customer at time that they want it. And then on the manufacturing side, there is definitely a lot of opportunity to improve, both on the productivity front and the cost front. So, that is going to become a central focus for cycles over the next six months to the year.

Meet Jain: So, on a growing industry outlook is there a good prospect for the cycle, means probably transports and all? Cycle as a thing means the current market is like a trend, people go for premium bikes and off-roading kind of. So, is there an uptick in the overall industry outlook in cycles?

Vellayan Subbiah: Yes, we are seeing growth in specials this year, and that is encouraging. So, the market overall for specials this year is going up, and so that is quite encouraging for us.

Meet Jain: One more thing, I am trying to contact Mr. Mahendra Kumar for a while, if I can just have a word with him after the con-call if possible?

Mahendra Kumar: Sure, we can do that.



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Modertor: Thank you very much. Our next question is from the line of Vipul Shah, an individual investor. Please go ahead.

Vipul Shah: Can you give the cycle volume in this quarter and what is the figure for specialty in that?

Vellayan Subbiah: I don't think we share volumes at that granular level, so Vipul we will prefer not to share volumes at that granular level.

Vipul Shah: And can you comment on the capacity utilization for engineering division and are we planning any CAPEX there?

Vellayan Subbiah: Yes, so we are expanding our Rajupura facility as we speak. And the idea is purely one of regional balancing. So, right now we are servicing quite a bit of the northern region from Chennai, and we are going to move that to Rajpura and then focus Chennai more on the exports front, and south volumes. So, basically, we are spending capital in Rajpura to expand capacity there. And to your first question in terms of CDW capacity, we are running pretty much flat, in the very high 90s in terms of CDW capacity.

Vipul Shah: And so what is the CAPEX at Rajpura for this engineering division?

Vellayan Subbiah: Again, I don't think we will share at that granular level, but we are significantly expanding the capacity at Rajpura for production there.

Modertor: Thank you very much. Our next question is from the line of Kashyap Pujara from Axis Capital. Please go ahead.

Kashyap Pujara: Sir, just to basically ask you on the debt levels, overtime would you be comfortable with bringing down debt to working capital levels or do you think that you will be comfortable with the debt free kind of status. What are your thoughts on that?

Vellayan Subbiah: So, I'd say the right answer, Kashyap, for us is between those two numbers. The thing that is still indeterminate for us and we are doing more thinking on it. So, structurally we are more comfortable with debt free, because it gives us the opportunity. The way I looked at it acquisition of growth strategy for us in the more medium-term is that we would really do it when a significant opportunity presents itself, which can be in the form of distress and things like that. So, I always think that it is good to keep a very strong balance sheet, so it enables you to do that when that opportunity presents itself. But what we have to trade-off with in the near-term is our ability to keep generating the revenue growth and not hampering the revenue growth because we are too focused on getting to a zero-debt structure. And so, from that perspective I would say that the thinking is, first, let's get it down to working capital levels, which is the first goal, and then look at whether further reduction of debt then kind of begins to hamper growth or it allows the



growth levels that we want from a revenue perspective. So, our first objective, Kashyap, is really to ensure that revenue growth happens. And if in the process we are also able to bring debt down to zero, then so be it.

Kashyap Pujara:

Great, I think that is an early field perspective to get. But just to extend you on revenue growth, what are your thoughts on inorganic? Actually, the thing is, is it that for the next two, three years we have ample to do on the organic front so we continue there and inorganic initiatives would be maybe down the line or would you be open to look at it if they were to present you in terms of adjacencies or new expansions? How do you look at inorganic?

Vellayan Subbiah:

So, in organic, if you take acquisition definitely, we will only do a distressed opportunity which is a good fit for us. We would not do any fully priced acquisitions over the next two to three years. And basically, the new businesses that we can identify and existing businesses, there is enough opportunity for growth. So, the only reason to do an acquisition would be if there is a stressed asset that presents itself in an area of interest to us, that could be interesting for us to look at. Besides of that we would not do any other acquisition.

Kashyap Pujara:

And I just wanted to pick your brains on the industry, while we have grown pretty well in the current quarter despite cycles not contributing to growth, but overall when we hear the commentaries on the automotive side, it is still a pretty mixed story and the season, mostly the festive season for cars, etc, has not been so strong. And there are hopes lined up on Diwali and beyond. So, what are your thoughts on automotive business in the remainder of the year? Do you see growth issues in second half, how do you read the early trends?

Vellayan Subbiah:

Kashyap, I think you guys are always in a better position to pick these trends than we are, we only see one side of the elephant as it were. I think that what we are seeing, especially engineering business has done a great job on by just increasing the focus on exports significantly. And I think that that has to be the way to offset any softness in the domestic sector. And so I would say that two of our businesses definitely where strong export focus is there, in the metal formed business not because of us but because of our customers. And so that definitely helps us. But as far as what is going to happen to the domestic, honestly Kashyap, I am not the expert.

Modertor:

Thank you. Our next question is from the line of Kashyap Kartik from Table Tree Capital. Please go ahead.

Kashyap Kartik:

Sir, I joined the call a little bit late, just wanted to check the visibility about Shanthi Gear. And not just visibility, the order book numbers are given, but if you could just tell us how the competitive scenario is coming on, given the increased demand on transmission gears and are there any import threats? Just from a competition and not just from a Elecon perspective but an overall competition perspective on Shanthi Gears?



- Vellayan Subbiah:** I don't think the business is as much about import threats, it predominantly Elecon. I would say that the ability, what you are seeing is both seems to be as capacity, from what we can tell. And therefore both have strong order books and there are two ways to interpret strengthening order book, because basically you also have to be able to fulfill against that order book in the near-term. So, our focus is really shifting to that. And I think it is the same for the competition as well, both sides are basically looking at how they can start fulfilling against the order books. But we are not seeing much on the import side, and we do not see too much of that coming in as well. The import side has always been much more expensive than the domestic players.
- Kashyap Kartik:** And just on the order book, not just the absolute number per say, but if you could just give some color around the sustainability of this order book over the next year or two, what are the critical drivers that you are seeing for the order book to increase in the last quarter and sustainability over the next year or so?
- Vellayan Subbiah:** So, I definitely do think that the market is very strong, demand is definitely going up. So, we do see the order book strengthening. And I would say that over the next 12 months we definitely see that order book strengthening more.
- Kashyap Kartik:** And any critical driver, all of a sudden, we are kind of seeing a traction over the last quarter or so, because we have not had any traction over the past couple of year. I mean, we have tried multiple elements, multiple sale strategies but still we have got traction, not just Shanthi but general industry was not that CAPEX driven. So, if you could just give some color on what are the drivers for seeing that visibility?
- Vellayan Subbiah:** I think the biggest has to be the infrastructure spending, it is basically the couple of key industries, if you take steel industry is running flat out, for example, cement picking up. So, just basically drivers like that who then kind of come back to better order books for us, because a lot of our customers tend to be in those infrastructure related industries.
- Kashyap Kartik:** And sir last question, so from Rs. 150 crores kind of order book do we, I know it is difficult to predict the future but do you kind of see a traction where the order book can potentially double in the next two years or is it too far to call out?
- Vellayan Subbiah:** See, like I said, one thing is the order book doubling. Like I answered an earlier question on this, perhaps you were not on the call, the bigger challenge is that we are running pretty much flat out in terms of production. Which basically means that the capability to enhance revenues significantly is mitigated by the fact that you cannot produce too much more. So, that is the gating factor here, and that is what we need to look at.
- Modertor:** Thank you very much. That was the last question in queue. As there are no further questions, I would like to hand the conference back to Mr. Kashyap Pujara for closing comments.



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Kashyap Pujara:

Thank you, everyone. And wish you a Happy Diwali. Thank you to the management of Tube for being there on the call and answering all the questions. Thank you, sir.

Modertor:

Thank you very much. On behalf of Axis Capital Limited, that concludes his conference. Thank you for joining us. And you may now disconnect your lines.