# "Sarla Performance Fibers Limited Q3FY15 Earnings Conference Call"

**February 18, 2015**

**MANAGEMENT:** **MR. KRISHNAKUMAR JHUNJHUNWALA – MANAGING DIRECTOR & CHIEF EXECUTIVE OFFICER, SARLA PERFORMANCE FIBERS LIMITED**

**Moderator**: Ladies and Gentlemen, Good Day and Welcome to the Sarla Performance Fibers Limited Q3FY15 Earnings Conference Call. This conference call may contain forward-looking statements about the company which are based on the beliefs, opinions, and expectations of the company as on date of this call. These statements are not the guarantees of future performance and involve risks and uncertainties that are difficult to predict. 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 floor over to Mr. Krishnakumar Jhunjhunwala – Managing Director and CEO, Sarla Performance Fibers Limited. Thank you. And over to you, Mr. Jhunjhunwala.

**K Jhunjhunwala:** Good Afternoon and A Very Warm Welcome to everyone. I hope you have received our Results and Presentation by now. For those who have not you can view them along with the presentation on our website.

I like to start this call with a brief introduction of our company, Sarla Performance Fibers. Sarla is a 100% Export-Oriented Unit, focused on Specialty Polyester and Nylon Yarns, in the field of Narrow Fabrics, Hosiery, Inner Wear, Sports Wear, Threads and Industrial Yarn. We maintain a strong relationship with more than 100 international customers across 40 countries prestigious brands having global presence, catering to customer needs across various geographies, we offer a wide range of products from an integral part of the final product which are customized as per clients requirements. Our overseas operations in Portugal, Turkey and manufacturing operations in the United States give us a wider reach to service our customers. We are the only Indian company in this sector to have manufacturing presence in NAFTA and CAFTA regions. Having understood the importance of proximity and visibility to our customers, we had the necessary encouragement to set up our overseas manufacturing facility in the US. Over the last few years, we have emerged as one of the leading Yarn players in a specialized and higher value added Yarn segment, having long-term business relationship with large global clients like Hanes brands. Normally, players in our sector stop at the POYor the Textured Yarn stage. Whereas we bring further value to our products by undertaking various other processes like covering, twisting, dyeing which adds value and gives our products the distinctive characteristics based upon the customer needs. In India, we have two manufacturing facilities at Silvassa and a dyeing facility at Vapi. In 2013, we added the installed capacity of 450 tons p.a. for Nylon 66 at Silvassa; this is a high tenacity product. This capacity is running at pilot stages and is awaiting product approvals. This is a specialized product used in parachutes, car airbags, specialized sewing applications in automotives, shoes, leathers, industrial filters and hoses. Being a niche product on its own, it is extremely specialized and hence margins are substantially higher. In 2013 also, we put up this new manufacturing facility in the US. Basically, in Textiles, all the major decision-makers are mainly based in the US; they may manufacture anywhere in the world but decision-makers are all in the US. So, setting up this US facility helped us to get closer to these clients. Presence in the US helps building confidence, relationship with these clients. Sarla, like I said, is the only player to have a manufacturing presence in this sector in US as well as India. Manufacturing facility in Charleston, South Carolina in US is going to be an integral part of our business. This US facility is spread over 42 acres having a constructed area of around 3.5 lakh sq.ft. Total cost incurred to acquire this land was approximately Rs.4 crores as land was procured from the county which was a non-profit organization. This facility would help us to save cost like logistics, power and borrowings. With these benefits, the final manufacturing costs would be close to a similar to those costs incurred if produced in India.

Total project costs there was about US$14 million. This plant is operational with the production of partially oriented Yarn (POY) and Textured Polyester Yarn since December 2013.

As of March 2014, our net debt obligation stood at Rs.986 million. Our company successfully completed QIP in October 2014 of Rs.467 million. With this infusion our net debt-to-equity stands at 0.43. Of the total debt of Rs.986 million, Rs.483 million is towards our US operations.

.I mentioned that our company successfully completed QIP in October 2014 of Rs.467 million.The proceeds from the QIP are currently kept in a bank fixed deposits and would be used mainly for the Phase-2 expansion of the US facility at a future appropriate time.

Now, I would like to update you on the operational performance of the company for the nine months' period of 2015. Our US operations are going through a stabilization phase. We would therefore discuss the performance of the company for the US and other geographies separately.

At the consolidated level, the company registered revenues of Rs.2,415 million in the nine-months period ending December 2014 as against Rs.1,912 million in the nine-months of financial year 2014. Basically, growth of 26% on a year-on-year basis. Excluding the US operations, the company registered revenues of Rs.2,120 million, growth of 11%.

Gross profit grew by 38% of Rs.892 million in the nine-months period to Rs.1,234 million in the nine-months period of financial year 2014. Excluding the US operations, gross profit grew by 19% at Rs.1,059 million, a margin of 50%.

EBITDA in nine-months period is at Rs.434 million as compared to Rs.384 million in the nine-months period of financial year 2014, growth of 13%. Excluding the US operations EBITDA stood at Rs.498 million, showing a margin of 24% and a growth of 30% year-on-year.

Profit after tax for the nine-months period financial year 2015 is Rs.221 million, whereas cash profit is Rs.342 million in the nine-months period of financial year 2015 as against Rs.329 million in the nine-months period of financial year ’14 growth of 4% year-on-year. Net profit margin is 9% whereas cash profit margin is 14%. Excluding the US operations, profit after tax for nine-months period financial year ’15 is Rs.342 million, showing a growth of 32% year-on-year, whereas cash profit is Rs.418 million in the nine months’ period, growth of 27% year-on-year. Net profit margin is 16% whereas cash profit margin is at 20%.

Now, I open the floor for Q&A.

**Moderator**: Thank you very much. Ladies and Gentlemen, we will now begin the question-and-answer session. The first question is from the line of Jeevan Patwa from CandyFloss Advisor. Please go ahead.

**Jeevan Patwa**: I want to understand first of Indian business. So how much would be the current capacity utilization of the Indian business?

**K Jhunjhunwala:** Close to 95%.

**Jeevan Patwa**: And Nylon 66 plant is yet to start, right, that is 4,500 tons plant?

**K Jhunjhunwala:** It is 450 tons.

**Jeevan Patwa**: What kind of revenue target on this full capacity utilization?

**K Jhunjhunwala:** Like I mentioned this is a pilot plant. I think at full revenue capacity it should be about Rs.15 crores. Once we are successful with the product approvals, we already have the utilities and everything in place to install further capacity of 4.5 tons per day more which would be about 3x more, we could put about 1600 tons p.a., as compared to 450 tons now.

**Jeevan Patwa**: In the US, you have the capacity right now of 9,000 tons?

**K Jhunjhunwala:** Correct.

**Jeevan Patwa**: At full capacity how much would be the revenue contribution?

**K Jhunjhunwala:** Will be about $36 million.

**Jeevan Patwa**: And you are going to increase it to 18,000 tons by 2017?

**K Jhunjhunwala:** Correct.

**Jeevan Patwa**: The margins in the US would be at par with Indian capacity, that is something 24% EBITDA that you said, right?

**K Jhunjhunwala:** I would say definitely on par, if not better.

**Jeevan Patwa**: Definitely, it cannot go below than 24%?

**K Jhunjhunwala:** Correct.

**Moderator**: Thank you. The next question is from the line of Sunil Jain from Nirmal Bang. Please go ahead.

**Sunil Jain**: This is more related to US operation. Sir this quarter again we are not able to see any growth in the volume. How is the situation now? And how much volume we are doing per month in the current quarter?

**K Jhunjhunwala:** Basically, last quarter which is December-ended quarter, we were utilizing about 25% of our capacity. This quarter we should be close to 30-33% which is more or less our breakeven. So I am very hopeful you either break even this quarter or the first quarter of the next financial year.

**Sunil Jain**: Do we see any good customer addition in the current quarter?

**K Jhunjhunwala:** Basically over there first you have to go through all the qualification process which we have gone through in all the customers. It is a question of them deciding at their end what percentage they would want to buy from us, At full capacity we are at $36 million. Now for Hanes we have a relation with them for the last 8-years We have exclusive warehouses for them in Vietnam and Thailand. Yarns have all been qualified which is a question of them giving us a certain percentage of their businesses.

**Sunil Jain**: So the only point was like this could be a delay from the customer point of view, we are ready to supply any time?

**K Jhunjhunwala:** Absolutely. Basically, like I said this quarter we are hopeful of reaching a break even. If not this quarter then definitely the first quarter of the next financial year.

**Sunil Jain**: My understanding is that in US, we are manufacturing more of generic or common variety of Yarn…

**K Jhunjhunwala:** We are starting with that, Sunil, because training up the workforce to get them to start with the basic…

**Sunil Jain**: Yes true, but my question is if suppose we are starting that, if a plant with generic commodity, why it is taking time to reach to a full capacity because normally what happens if a commodity sells like a commodity, so it can be sold easily.

**K Jhunjhunwala:** Yes but today, we do not want to sell to non-compliant uses or compete against imports. Today, basically, we do not want to compete against imports from India or China into the US because those are non-compliant Yarns. Idea is to go into customers who want compliant yarns, for which they are able to pay a premium.

**Sunil Jain**: So you intentionally choose to go to specific customer or a specific market only, that is why you are not going to very generic kind of…?

**K Jhunjhunwala:** Correct.

**Sunil Jain**: About this Nylon 66, whatever was the process going on and a few of the customers who are looking at our product and all, so any breakthrough on that side?

**K Jhunjhunwala:** Yes, we have got our first approvals. First shipments are going out next month, and hopefully, for all the end users what we are targeting including car airbags, etc., once again in the first quarter of next financial year, we should be more online with that product.

**Sunil Jain**: About this capacity expansion from 9,000 to 18,000 tons, at what level once you reach in existing capacity then you will start thinking on expansion?

**K Jhunjhunwala:** Definitely, 50-60% capacity utilization currently because what happens is today, say, you are a customer buying $90 million which is 3x my capacity, I give you 20% of my business, this 20% of business is say $18 million, then can you go up to 40% of my business. Once you start giving me business, I have to start giving you answers.

**Sunil Jain**: By mid of the next year, you may be thinking about starting your expansion or maybe even before that?

**K Jhunjhunwala:** Like I said it all depends, once we start keep getting the business rolling it will take a year from the time we commit ourselves to the machinery suppliers, it will take a year to get it online.

**Sunil Jain**: About other supply from India, any impact of so much fluctuation in the currency on your profitability because euro has depreciated by around 8-9% post 31st December?

**K Jhunjhunwala:** Basically, most of our supplies are in US dollars and again like today if you are supplying to customers it does not hit their margins, they do not come upon you so much.

**Sunil Jain**: You supply in dollar term, but they are not coming back for any reduction in price and all?

**K Jhunjhunwala:** They have come back. Basically with the raw material reduction and the euro reduction as compared to the dollar, they have come back and basically today with the raw material reduction they are more or less at the same price in euro levels.

**Sunil Jain**: Overall, my point is like will this have any impact on the future margins or not?

**K Jhunjhunwala:** No.

**Moderator**: Thank you. The next question is from the line of Keshav Jayant from Equitree Capital Advisors. Please go ahead.

**Keshav Jayant**: Just wanted to check one thing; while I understand that Nylon 66 will be I think the main product which will be driving your growth going forward. I just wanted to get a sense as to what is the company's vision on at a consolidated level, what is the growth you all are foreseeing for the next year or the year after?

**K Jhunjhunwala:** Basically, the Indian operations, as you have seen traditionally, will grow around 10% every year apart from the growth driver of the Nylon 66. That is successful, that could enable a higher growth.

**Keshav Jayant**: But when do you foresee this product going into mainstream production?

**K Jhunjhunwala:** Like I said first quarter of the next financial year.

**Keshav Jayant**: The product has been approved?

**K Jhunjhunwala:** Yes, in some cases, it has been.

**Keshav Jayant**: So by the first quarter you are looking at the first batch which you had mentioned…

**K Jhunjhunwala:** No, first shipments are going out in March this year and approvals in other segments we are expecting in the first quarter.

**Moderator**: Thank you. The next question is from the line of Ritesh Poladia, he is an individual investor. Please go ahead.

**Ritesh Poladia**: When do you think that any major customers would be signed up for the US facility?

**K Jhunjhunwala:** I expect certainly by the first quarter of next financial year.

**Ritesh Poladia**: By that time we would be managing just about breakeven on the US facility?

**K Jhunjhunwala:** As a matter of fact, till December, we are having cash losses, but we are hopeful of breaking even either in this quarter or in the first quarter next year.

**Ritesh Poladia**: On the Nylon 66 what kind of investments we have done so far?

**K Jhunjhunwala:** We have done about Rs.11-12 crores over there in trial plant.

**Ritesh Poladia**: If it go successful, what kind of investment we would be doing?

**K Jhunjhunwala:** Basically, the building and all infrastructure already there, utilities are already there, expanded 3x more, like to 4.5 tons today, we are 1.5 tons per day to make it 6 tons per day increasing by 4.5 tons. We believe that this should take Rs.10-12 crores only.

**Ritesh Poladia**: So right now our asset turnover on trial plant would be close to 1, but if on expanded capacity it might go till about 2?

**K Jhunjhunwala:** Correct.

**Moderator**: Thank you. The next question is from the line of Kunal Shah from HDFC Securities. Please go ahead.

**Kunal Shah**: Recently, we heard that the government is going to make it mandatory for all new passenger cars to have Airbags, right?

**K Jhunjhunwala:** Correct.

**Kunal Shah**: So how do we see the opportunity there?

**K Jhunjhunwala:** Basically, there is no airbag manufacturers as far as I know in India, all the Airbags are imported. We are the suppliers to the airbag manufacturers. So it depends on which airbag manufacturer like Takata or somebody actually wants to come into India and manufacture. Till now we see no interest as such.

**Moderator**: Thank you. The next question is a follow up from the line of Jeevan Patwa from CandyFloss Advisor. Please go ahead.

**Jeevan Patwa**: I just wanted to understand, I read that we are the only company who are going to manufacture Nylon 66 in India, that is right?

**K Jhunjhunwala:** Correct.

**Jeevan Patwa**: So right now it is all through import, how much is the total demand in the domestic market?

**K Jhunjhunwala:** I can tell you about two major users who are our existing customers. They should be using about close to 1500-2000 tons per year and it is all imported.

**Jeevan Patwa**: So will there be any pricing difference you see between the import and the one that you are going to make?

**K Jhunjhunwala:** When we go into a customer with a product, looking at import replacement, we will have to start slightly lower. They will have advantage, they do not have to import, and they are getting a product domestically from a known vendor. We have been supplying them the Nylon 66 product and the other products what they are buying. So it should not be very difficult once we have the products specs met.

**Moderator**: Thank you. The next question is from the line of Saurabh Patwa

**Saurabh Patwa**: I have few questions regarding long-term outlook: Firstly, I think the gross margin improved in this quarter sharply largely because of fall in the crude oil related to again which the raw material prices could have come down, but what would be the long-term sustainable gross margins for the company including the US operations?

**K Jhunjhunwala:** Wherever any product that we can keep our raw material ratio to say as low as possible, situation in raw material should not affect us too much. I would maintain that whatever margins you are seeing now should be maintained.

**Saurabh Patwa**: This is the lowest raw material to sales from last like 3-4 years, earlier it used to be more than 50% historically, so this time just fallen below 50%?

**K Jhunjhunwala:** Basically, our idea is once you get more and more into value added chain to have the raw material to sales ratio between 40% and 45%.

**Saurabh Patwa**: EBITDA margins again you believe that 18%-19% you should be able to maintain it, last 2-3 years we have been able to do that?

**K Jhunjhunwala:** Correct.

**Saurabh Patwa**: At full capacity pre-expansion of second phase, I understand it is a factor of the prices and valuation and the sales mix, etc., but largely it should be in which direction would be of like how much value in value terms for US as well as India, so total consolidated before the Phase-II expansion if assuming like 50-60% you are saying?

**K Jhunjhunwala:** India and other geographies, we have around Rs.300 crores and US like I mentioned $36 million, so say about Rs.200 crores. So we should be around Rs.500 crores at US full capacity utilization of Phase-I before Phase-II.

**Saurabh Patwa**: Phase-II would again be additional Rs.200 crores something?

**K Jhunjhunwala:** Correct.

**Saurabh Patwa**: At that level the margins would be around like 18-19% range? This would not impact the margins in anyway. As capacity increases and utilization improves in US, so the EBITDA margins in US will also come to a range of around 18% which would be lower right now?

**K Jhunjhunwala:** Correct, as a matter of fact, we are making cash losses there, you must have seen.

**Saurabh Patwa**: That is what, it will improve, and so overall margins will actually increase slightly?

**K Jhunjhunwala:** Correct.

**Saurabh Patwa**: The other income has fallen sharply in this quarter. Any specific reason for that?

**K Jhunjhunwala:** Other income basically in the last quarter is the dividend which we get from the overseas holding company, basically, the government allows you to set off the dividend distribution tax against the dividend received by the company. So dividend is going to be ongoing every September quarter.

**Saurabh Patwa**: Otherwise, it should be in the range which is there currently?

**K Jhunjhunwala:** Yes.

**Moderator**: Thank you. The next question is from the line of Charandeep Singh from Girik Capital. Please go ahead.

**Charandeep Singh**: I just wanted to get an update on Nylon 66. I think last time we spoke, there were trials happening and all that, but where do we stand now?

**K Jhunjhunwala:** Like I mentioned product approvals have been received about three weeks ago. The first shipments are going out next month. And like I mentioned other approvals for other areas like Airbags, etc., we expect to get by April.

**Charandeep Singh**: This is the large hurdle cross for you all in terms of product approvals. But what is the immediate revenue potential for something like this because I know that there is a large potential import substitution that the likes of Vardhaman Coats do, they import quite a lot of it. So what are you really targeting here minus Airbags?

**K Jhunjhunwala:** Basically first is like to get this pilot plant running full, then when you visited our facility, we already have the space for adding 3x more. So going for 1.5 tons to 6 tons per today is the first intention. Then as it is successful, basically, you can keep on increasing that area.

**Charandeep Singh**: So basically shipping out to both these customers already?

**K Jhunjhunwala:** Not to those two, some other end users like I mentioned.

**Charandeep Singh**: Export or domestic?

**K Jhunjhunwala:** Export.

**Moderator**: Thank you. The next question is from the line of Neha Shah, she is an individual investor. Please go ahead.

**Neha Shah**: I just wanted to know, any plan of introducing a new product this quarter or say coming quarters?

**K Jhunjhunwala:** In India Nylon 66 like I mentioned, in the US once it stabilize, we can go on to Yarn for Automotives, etc., but definitely not this quarter.

**Neha Shah**: So when are you expecting that your US facility will be stabilizing, showing some positive results?

**K Jhunjhunwala:** Like I mean this quarter we should be close to breaking even, if not this and then the first quarter of the next financial year.

**Neha Shah**: You have raised QIP around Rs. 467 million. So what are the plans for the money?

**K Jhunjhunwala:** As mentioned, basically, right now that money is kept in a bank fixed deposit. Moment we see the US stabilizing, we decide to go in for Phase-II, we will make our commitment to the machinery suppliers, machinery deliveries about 8-12 months.

**Neha Shah**: I see that your nine months and even in Q3, your margins have been impacted. So is it because of expensive labor in the US, what are the reasons?

**K Jhunjhunwala:** Main reason is sales buildup. Today you are having the employees' payroll. Capacity utilization is 25%. That is going to impact and you are going to lose money. Moment the sales come up to 33-35% you start breaking even, and the payroll will be the same.

**Neha Shah**: On our raw material front, whether the drop in crude oil prices have helped you logging your raw material cost?

**K Jhunjhunwala:** Today, if your customers are very-very sensitive themselves, if there is a fall in raw material, they will ask you for immediate fall in the prices you sell to them.

**Moderator**: Thank you. The next question is from the line of Sushil Bhojwani from Elara Capital. Please go ahead.

**Sushil Bhojwani**: A couple of questions from my side: I wanted to understand, one, you said that your domestic operations are almost at 95% capacity utilization, right. So I want to know if there are any plans there? And second, have you done any kind of study whether you kind of feel this Nylon-66 as a product, what can be the industry for such a product and since you are going to be the one who is going to be like a monopoly, then probably after you reach the additional capacity, you can probably scale up to what levels in Nylon 66?

**K Jhunjhunwala:** The initial thought Sushil right now is to get the 1.5 tons successful, can get up to 6 tons and then take it from there.

**Sushil Bhojwani**: But then obviously if things like compulsory Airbags and all of that happen, obviously, the industry size would also grow, right, so you have kind of thought about the scalability of this product, anything on that side?

**K Jhunjhunwala:** Right now get it up to 1.5 to 6 tons is good enough is our thinking process, next step once you see the product acceptability, etc., once you have the knowledge, the know-how, to add machineries is easy.

**Sushil Bhojwani**: 95% capacity utilization is going to stay there, right?

**K Jhunjhunwala:** What happens is capacity utilization today for example if you are selling a product at say $5, same product can be sold at $7-7.5-8 rather to that then add for more capacity. So capacity I would say in more value-added stuff if you invest. You may be selling 5 tons at $5 each but if you can sell the same 5 tons at $7 or $8 each, is what we are looking at.

**Moderator**: Thank you. The next question is from the line of Ritesh Poladia, an individual investor.

**Ritesh Poladia**: Just want to know any update on the Honduras JV?

**K Jhunjhunwala:** We have a criminal case against them, so hopefully we should get a settlement either this year or next year.

**Ritesh Poladia**: This would be about 12-15 months kind of negotiations happening?

**K Jhunjhunwala:** Correct.

**Ritesh Poladia**: When we met, you had mentioned key challenge in US would be of human resource. So, now we are also looking for an expansion. Now what do you see how we can manage this?

**K Jhunjhunwala:** Basically, after spending almost 14-15 months there, the workers are much better trained than we started this. So once the capacity utilizations come up, and for Phase-II the worker requirement will not be so much, once you have the trained workforce, and again, you attract talent basically once they know you are a stable company to work with, people want to work with you. Why would they work in a McDonald there or Walmart? They would rather come and work for you if you pay them higher wages.

**Ritesh Poladia**: That was the initial learning of which I believe now is past. So now the things would be pretty smooth for you?

**K Jhunjhunwala:** Let us hope so.

**Moderator**: Thank you. The next question is from the line of Kapil Gada from RJ Capital. Please go ahead.

**Kapil Gada**: I just wanted to know, is there any plan for Phase-II expansion of the US facility?

**K Jhunjhunwala:** Like I mentioned, once we are stabilized over there, have a decent capacity utilization, we would go for the Phase-II.

**Kapil Gada**: Right now the drop in the crude oil prices, does it help into lowering the raw material cost?

**K Jhunjhunwala:** Sure.

**Moderator**: Thank you. As there are no further questions I would now like to hand the floor over to Mr.Krishnakumar Jhunjhunwala for closing comments.

**K Jhunjhunwala:** I take this opportunity to thank everyone for joining on the call. I hope we have been able to address all your queries. For any further information, kindly get in touch with me or Strategic Growth Advisors, our investor relation advisors. Thank you once again.

**Moderator**: Thank you. On behalf of Sarla Performance Fibers Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.