304, Arcadia, 195, Nariman Point, Mumbai - 400 021, Maharashtra, India

Sarla Performance Fibers Limited

Earnings Conference Call Transcript
June 04, 2013

Moderator

Ladies and gentlemen, good day and welcome to the Sarla Performance Fibers Limited's Q4 and FY13 Earnings Conference Call. As a reminder for the duration of this conference, all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference please signal an operator by pressing * and then 0 on your Touchtone telephone. Please note that this conference is being recorded. At this time I would like to hand the conference over to Mr. Rishab Barar of CDR India. Thank you and over to you, sir.

Rishab Barar

Good afternoon everyone. We welcome you all to Sarla Performance Fibers Limited's first analyst and investor conference call. Here we shall discuss the performance and financial highlights of Q4 and FY 2013. Today we have with us Mr. Krishna Jhunjhunwala, Managing Director and Mr. Mahendra Sheth, CFO & Company Secretary. We will start this concall with opening remarks from the management after which, we will have the floor open for an interactive question and answer session. Before we begin, I would like to point out that certain statements made in this concall maybe forward-looking in nature and a disclaimer to this effect is included in the investor release and the concall invite which was sent to you earlier.

I will now like to handover the floor to Mr. Jhunjhunwala to make his opening remarks before we start the question and answer session. Over to you Mr. Jhunjhunwala.

Krishna Jhunjhunwala

Good afternoon everyone and welcome to our results conference call. I will take you through the operational performance and key financial highlights during this quarter. For Q4 FY13 net sales from operations stood at Rs. 64.35 crore compared to Rs. 46.96 crore in the corresponding quarter last year. Our EBITDA was Rs. 7.87 crore from Rs. 9.53 crore in Q4 last year. Operating margins stood at 12.22%. Margins were impacted due to draw back claims which were accounted for but still not received. As a measure of prudent accounting policies we have reversed these claims until we receive the payment to a one off situation. Also we incurred a one-time write-off and expenses which have the impacted margins. Adjusting for these item margins are actually better than the previous year. Net profit during the quarter was Rs. 1.26 crore compared to Rs. 4.94 crore in the corresponding period last year.

For FY13 net sales from operations stood at Rs. 258.69 crore compared to Rs. 222.64 crore in the previous financial year. Our EBITDA was at Rs. 47.61 crore from Rs. 34.51 crore in the last year. Operating margins stood at 18.4%, net profit during the year was Rs. 27.97 crore compared to Rs. 18.92 crore in financial year 2012. EPS for the year was Rs. 40.25.

This being our first formal interaction through this medium, I would like to take a little time to share with you some perspectives of our business. Sarla Performance Fibers began with its first manufacturing unit in Silvassa for polyester textured and twisted yarns. Currently Silvassa has two manufacturing units with an installed capacity of around 11,900 tonnes per annum. The company established an in-house dyeing plant in Vapi broadening the product offering to dyed yarns. The dyeing unit which is well equipped with the state of the art technology has a capacity of around 3,200 tonnes per annum. We began operations as a manufacturer of commodity yarns and have now successfully progressed to specialized and higher value added yarns. There is a huge opportunity for these value added products across the globe. Specialized yarns target multiple niche end user industries like automotive seat belts, strings, air bags, upholstery, casuals and athletic footwear, leather goods, soft luggage and lingerie to name a few. These products help us to gain higher margins and have resulted in long term customer relationships. We have been successful in penetrating the global markets and have tied up with well-known brands. These high end brands lay a strong emphasize on quality and it is through our ability to match the requirements that we have been chosen to service them. We are hopeful that in the near term with our ability to customize products for each individual customer requirement and specification, we will be able to add more global customer names to our portfolio.

We are now establishing a manufacturing unit in South Carolina, USA for the extrusion of partially oriented yarn and textured polyester yarns. The reason we decided to go ahead with this initiative was primarily on account of the CAFTA & NAFTA treaties which gave immense benefits for companies that manufactured products in the United States. Duties to the extent of 32% were waived off that would otherwise be charged on imports from countries such as India. Aside from the duty differential advantage, proximity and visibility to customer is expected to contribute significantly towards expanding and deepening customer relationships.

Freight costs are reduced considerably. Power costs are half that of India and although labor is more expensive there will be a high level of automation which will reduce the labor work by about 30%. Also the cost of borrowing is extremely low in the US as compared to that in India. With marketing initiatives in place we would be able to increase our presence in these countries even further. We see ramp up in the production to take place over the next two years and are very excited about this venture. Although there will be an increase in interest and depreciation cost in the beginning of this project we are confident that it will play a big role in contributing to our performance in years to come.

One of the points that I am extremely glad to share is that this is the first POY plant that has been set up in that region after almost 25 years. This project will create approximately 100 new jobs in the region and the total investment in the business is around $13.8 million out of which $7.8 million is debt and remainder from internal accruals. This project should commence production by September this year. Also it is very important to note that the realisation for products in the USA are considerably higher than in Asia and the Far East which will help in increasing margins considerably.

In India, we are amongst the first companies to begin manufacturing covered yarns and today have the largest manufacturing capacity for air covered and conventional covered yarns in India.

We have begun the manufacturing of Nylon 66 which is a high tenacity low shrink yarn and niche on its own, with margins substantially higher. This product is very useful for end user industries like parachutes, air bags, shoes and lingerie. Nike itself is estimated to invest $100 million per year in this product. We are proud to say that Sarla is the only company in India and amongst few in the world to manufacture high tenacity Nylon 66 yarns. Like Nike there are several leading brands across the space who will be inclined to use Nylon 66 and we are hopeful that over a period of time we should be able to bag business from them.

We have always believed that to tap in to foreign markets it is very important to have a local presence. Establishing a marketing subsidiary in Portugal, the westernmost country in Europe has enabled us to service the European region very well while bringing us closer to the booming textile industry in South America. Through such strategies we have successfully tapped in to various markets and today supply to 40 countries across six continents.

Lastly, coming to our wind mill business we have made significant progress in this segment and what began with a capacity of 1.25 megawatts in 2010 in Maharashtra and Gujarat has now scaled up to a capacity of 7.25 megawatts, as on March 2013. This business has a high ROI and will only add to our company's performance in years to come.

Coming to balance sheet numbers gross debt as on 31st March 2013 stood at Rs. 111.74 crore out of which Rs. 41.63 crore is the long term debt with the remaining constituting working capital. The net worth of the company as on 31st March 2013 was Rs. 146.48 crore. Cash and bank balances held by the company at the balance sheet date was Rs. 5.04 crore and fixed deposits Rs. 16.51 crore. The long term debt to equity as of 31st March 2013 stood at 0.28:1.

This brings us to the end of our discussion. Now we would gladly address questions that you may have.

Moderator Thank you very much sir. Ladies and gentlemen we will now begin the question and answer session. Our first question is from Amol Rao of Anand Rathi, please go ahead.

Amol Rao It is very heartening to see our margins have come in really well this year. Just very curious, is that because we have had a cooling off in raw material prices or an increase in efficiency?

Krishna Jhunjhunwala I would say basically the raw material prices have been at the highest levels. If I see the raw material polyester is about 7% to 8% higher compared to financial year 2012. Today, our main focus is on building up relations. The cost of yarn in the garment, if you see, is negligible. The buyer wants to establish with somebody who can supply him the same quality product both in the eastern hemisphere and the western hemisphere. With the announcing of this US venture a lot of companies are coming to us, asking us if what we would supply them in the US we could also supply them to their contractors in India, China or Vietnam. Hence you will see a lot of growth coming from that side since we announced this US venture.

Amol Rao I could add another dimension to my question. Is this also because of probably a more favourable exchange rate that we have had an improvement in Rupee gross margins?

Krishna Jhunjhunwala That is definitely there. I mean apart from that we have had quantum growth also.

Amol Rao If I could get a rough ball park number how much is this volume growth?

Krishna Jhunjhunwala I can send that to you.

Amol Rao Second question was on our US project because last time we met around March and discussed about this project you had mentioned that this is on track to start by the end of September or beginning of October. What is the state of the project I mean has some equipment come or is the installation complete. Could you give us some more information on that?

Krishna Jhunjhunwala Yes, basically all the equipment is already there, the erection work is going on. Some of the downstream machines like the texturising and the twisting we are beginning to commission one-by-one. We started some trial production on the 13th of May. The main POY extrusion we expect to commission by September. So we should be on the stream with the whole project by the end of September and beginning October.

Amol Rao We have also mentioned that we had a certain amount of debt and the long term debt was around Rs. 42 odd crore in the company. Does this remain only for the wind business or is there anything else taken on for?

Krishna Jhunjhunwala I think Rs. 35 crore for wind and Rs. 6 crore for the US project.

Amol Rao Any further plans to put up anything in the wind space now?

Krishna Jhunjhunwala No, not now.

Moderator Thank you. Our next question is from Grishma Shah of Envision Capital, please go ahead.

Grishma Shah If you could tell us as we see from your revenue breakup, a part of the commodity yarn as a percentage of sales has decreased for us but there is some trading also that we have done, so I mean how do you link both of these?

Krishna Jhunjhunwala I think trading is a negligible amount primarily as we had opened some LCs for the machinery for the US project under the merchant banking route, so it is basically the sale of machinery from the Indian company to the US Company, that is around Rs. 10 crore.

Grishma Shah And you also mentioned that there were certain one offs during Q4 and you have reversed something, could you quantify both of these?

Krishna Jhunjhunwala One of that were basically the expenses for the US project like the LC costs etc. Basically this will be one off. I think it is about Rs. 1.5 crore.

Grishma Shah And you have also reversed something during the quarter?

Krishna Jhunjhunwala Drawback claims which we are expecting this year so we have decided that we account for them as and when we receive them and not when we are eligible. These is because as an export house you get certain licenses based on your exports. So we said let us account for them as and when we actually get them, not when we are eligible on a cash basis.

Grishma Shah What was that amount?

Krishna Jhunjhunwala Around Rs. 4.4 crore.

Grishma Shah In your results you have said the cash is around Rs. 20 crore, is that number right or is the Rs. 16.5 crore right?

Mahendra Sheth Rs. 5.04 crore are cash and bank balances and Rs. 16.51 crore is our FD, so in all it is Rs. 21.55 crore liquid assets that we have.

Grishma Shah And coming on to business how do you see growth, since in the second half of FY14 you would have your new factory coming on to stream, so how do you see the revenue growth for the company over the next three years?

Krishna Jhunjhunwala I think like I said this is quite an exciting period for us because we made this investment in the US along with this Nylon 66 what we are putting up over here in India. So the potential is there and I would not like to go in to specific numbers. I will probably say all along we have been growing at 10% to 15% more or less with our existing assets. So we have made this investment looking at a far higher growth and it does look quite an exciting period going ahead.

Grishma Shah How much of the growth in FY13, would be driven by the currency impact?

Krishna Jhunjhunwala I can send you that. We have the breakup how much is gone up due to currency and how much due to quantum. We will view it separately.

Grishma Shah What kind of volume growth if you could tell us, it may be difficult for you because realizations in Rupee-Dollar also play a part in terms of sales?

Krishna Jhunjhunwala I think our quantum has gone up by 10% as compared to FY12, the volume growth and roughly 10% due to the rupee exchange growth. I mean better realization.

Grishma Shah What kind of volume growth will you see going ahead? We keep the realization at the exchange rate as it is?

Krishna Jhunjhunwala I would say from India they are 5% to 10%.

Mahendra Sheth 10% is normal growth. Every year we do that.

Grishma Shah By how much will this new capacity increase our production?

Krishna Jhunjhunwala In the US?

Grishma Shah Yes.

Krishna Jhunjhunwala In the US we are looking at a production of 30 tonnes a day which is 900 tonnes a month. Once we are into full production we will be looking at a $30 million turnover annually, which is like almost more than 50% of what we are doing here. This is on a conservative basis.

Grishma Shah But that would take around six months to stabilize etc all of that?

Krishna Jhunjhunwala Correct.

Grishma Shah Post the capacity coming on stream and as the business picks up from that facility, do we see the debt going down?

Krishna Jhunjhunwala In India the only debt what we have is for the wind power, for the textile asset there is no debt at all. And for wind power also the debt we should be able to complete all Rs. 35 crore in the next three years. There is no plan as of now to take any more debts here or anything till we stabilize the US operations.

Grishma Shah Any outlook on the raw material side, how do you see that panning out for us?

Krishna Jhunjhunwala I would say it is going to be pretty much the same for this financial year 2014, I mean this capacity. So I mean for us, if our raw material cost is 50% of sales we are fairly okay.

Moderator Thank you. Our next question is from Paras Adenwala of Capital Portfolio Advisors, please go ahead.

Paras Adenwala Could you just tell me as to what is the total project cost for the US business?

Krishna Jhunjhunwala Around $13.8 million.

Paras Adenwala What is the kind of payback that you expect on this project?

Krishna Jhunjhunwala Four years.

Paras Adenwala In terms of connectivity with your existing business in India, how would it really work?

Krishna Jhunjhunwala I mean basically what we are going to manufacture there is commodity yarns which we do not manufacture in India. it will help Indian operations to get you in the league of the bigger names in textiles, most of the decisions makers in textiles are US companies and most of them are located in the US and having a presence there where they can walk into our plant would greatly help the Indian operations because all these US companies have operations all over the world. They are producing in low cost countries like China, Vietnam, Thailand and the Indian operations will greatly be helped by these companies telling us to ship from India to some of their operations in these South East Asian countries. And from the US operations itself, CAFTA and NAFTA we can take advantage of that wherein if you use a US yarn the garment itself becomes duty free when imported back in to the US. So it is not just duty saving on the yarn but basically duty saving on the garment itself which is a big thing.

Paras Adenwala In terms of your ROI, would this project be better as compared to the Indian business, so is it going to be value enhancing?

Krishna Jhunjhunwala Definitely yes. As far as our calculations goes on paper at least I am quite sure, once we are operational we will actually get the feel of things.

Paras Adenwala Second was on your consistency of growth or a predictability of growth as compared to some of the other peers in the textile industry, do you think there is a greater amount of stability and predictability in your business as compared to the rest of the guys?

Krishna Jhunjhunwala We have not gone in for an indiscrete expansion or indiscriminate borrowing for the sake of growing. For the last 6 to 7 years we have hardly made any investments because we did not find any good avenues to make investment and we have been just growing at 10% to 15% without resorting to any borrowings. We found this US project quite exciting which could propel the company to a next level. So that is why we have chosen this and like I have mentioned earlier the next couple of years is quite an exciting time for the company.

Paras Adenwala But would you like to set a target as to how would you like to see the company over the next three years in terms of the top-line, the bottom-line or the return on investment? Do you have any parameters set or the target set for yourself?

Krishna Jhunjhunwala Not yet. Once we have this US plant up and running then probably we will have a greater clarity.

Paras Adenwala But you know from our perspective since we have effected that in to our valuations, would it be fair to say that the kind of growth that you have averaged in the last three years is something that we can expect in the future as well?

Krishna Jhunjhunwala I think that will be quite easy.

Paras Adenwala I am talking from the local business not the incremental new US business?

Krishna Jhunjhunwala Yes from the local business I mean we have been growing at about roughly 10% to 15% every year, locally you can safely assume that.

Paras Adenwala And this is without any compromise on the margins?

Krishna Jhunjhunwala Yes.

Moderator Thank you. We have a follow up question from Paras Adenwala of Capital Portfolio Advisors, please go ahead.

Paras Adenwala If you have to break up your turnover customer segment wise, how would it look like?

Krishna Jhunjhunwala You mean percentage of sales to the largest customer?

Paras Adenwala Yes, in terms of customer concentration or also the customer segments like textiles or automobiles, if you could just give me the break up both ways?

Krishna Jhunjhunwala Primarily addressing your first question is we do not have any customer more than 3% for our sales. No single customer. Where the segments are concerned I would say hosiery would be about 25% to 30%, industrial 25% to 30%, apparel about 25% to 30%.

Paras Adenwala Geographically how is the sale kind of distributed?

Krishna Jhunjhunwala Once again I would say Central America, North America would be about 25% to 30%. Europe would be about 20%. Middle East which includes Israel and all would be about 15% to 20%. As a matter of fact China and Hong Kong including Thailand and Vietnam is close to 20%.

Paras Adenwala Which of these segments both geographically as well as the category wise shows a promise to you?

Krishna Jhunjhunwala Industrial.

Paras Adenwala And geographically due you think Asia is doing better as compared to rest of the countries when you talk about China and Vietnam and all other?

Krishna Jhunjhunwala See we have increased our exports in to these countries because of nomination from the US companies who have their plants there. One segment like I said which looks very promising to me is Central America. Costs in India and China has grown up tremendously apart from greater lead time. Central America has been virtually the backyard of the US. I would see a lot of US companies diverting some of the programs from India, China, Vietnam to these countries.

Moderator Thank you. As there are no further questions from the participants I would now like to hand the floor back to the management for closing comments.

Management Thank you again for joining us on the call today. I hope you got satisfactory answers to your queries. Please feel free to contact CDR for any further information or queries, we are more than happy to discuss it with you.

Moderator Thank you very much. Ladies and gentlemen on behalf of Sarla Performance Fibers Limited that concludes today's conference call.