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Investor Conference Call

First Quarter of Financial Year 2012-13

Aniket Mhatre, Standard Chartered

Good Afternoon! Welcome to the post results conference call of Apollo Tyres. From the management team we have with us Gaurav Kumar, Group Head, Corporate Strategy & Finance; Rakesh Dewan, Head, Accounts and Ritu Kumar, Head, Financial Planning & Control. I now request Gaurav to begin with his initial comments on the results and then we can take on the questions.

Gaurav Kumar, Apollo Tyres

Good Afternoon. And thank you for joining us on this call. The consolidated sales for the quarter were Rs 31.6 billion, up 12% over the same period last year. There was significant improvement in the EBITDA margin, which was at 11.4% compared to 8.7% last year; aided by a growing topline that allowed absorption of fixed costs over a much larger base. Moreover, raw materials too were slightly down compared to the same period last year.

The average raw material price for the quarter was Rs 160/kg, 2% lower than the same period last year. This has reduced primarily on account of Natural Rubber, down by around 15% compared to the June quarter of last year. However, on a sequential basis, compared to the March 2012 quarter, raw materials were up by 4%; largely attributable to rupee devaluation vis-à-vis the dollar.

In terms of revenue segmentation, about 75% of the revenue came in from the replacement segment. On a product category basis, 50% of the revenue came from truck-bus and 30% from passenger car.

The net debt figure was at Rs 29.5 billion with a leveraging ratio of 1:1, which is similar to last quarter.

Raw material prices are expected to remain at the same level, providing stability. With topline growth, the outlook looks favourable.

Moving on to specific Operations; Indian Operations reported a topline of Rs 21.5 billion with a growth rate of 10% over the same period last year. The growth rate has been lower, compared to Apollo's historical past, because of 2 key reasons. One, the demand was constrained, particularly from the OEM segment which saw a decline. Two, given the stable raw material scenario, there have been very few price increases in the last couple of quarters.

The EBITDA margin for the quarter was at Rs 2.3 billion. Margins have continued to improve sequentially, over the last few quarters, on account of raw material price stability and the fact that the Chennai Operations have reached a sizeable proportion. The net profit margin for the Indian Operations was at 3.5% compared to 2.3% for the same period last year; while the net debt was at Rs 21.5 billion.

In terms of revenue segmentation, 70% of the revenue was from the replacement segment. On a product category basis, two-thirds of the revenue has come from truck-bus and about 15% from passenger car.

The outlook remains decent, particularly on the replacement side; though the inventory pile up, due to a decreased demand at the OEM end, has obviously not worked in favour of the Indian Operations. Production was planned based on the outlook provided by OEMs, which proved to be incorrect, resulting in a large inventory. However, this should be taken care of by the September quarter.

In the next quarter, despite monsoons, which have traditionally resulted in softer volumes, the company expects to maintain the topline.

The African Operations' topline showed significant improvement, registering a growth of 40% vis-à-vis June quarter of the last financial year, resulting in sales of Rs 3.9 billion. The EBITDA margins were at 4.8% compared to 1.8% last year. And while at the net level the company was still at a small loss, it was a significant improvement compared to June quarter of last year. The target is to achieve a breakeven situation and then look at growth options.

The economy and the market continue to face a challenge from imports, particularly from China. But African Operations have grown on the back of exports and also by gaining some market share from other domestic players.

Moving on to the European Operations, quarterly sales were at Rs 6.5 billion, a growth rate of 8% over last year. Given the challenges in the European economy, the market was down 15%. There was no volume growth. The sales have been essentially driven by foreign exchange fluctuations and the product mix, and not price increases.

The improvement in product mix not only led to topline growth but also impacted the margins significantly. The EBITDA margins for the quarter was at Rs 1.2 billion, at 18% plus compared to 13.5% for the June quarter last year. The net profit was 10% compared to 6.5%. The decline in volume led to some inventory pile up compared to previous period in this quarter, which would get corrected by the end of next quarter.

Apollo Tyres rolled out a small price hike of 1.5% for the truck-bus cross ply replacement segment in Indian Operations. Similarly, for the South African Operations, the company took a price increase of 3% effective April 2012.

Lastly, Apollo ended the quarter with a capacity of 350 MT/day at the Chennai unit; and as per the plan would continue to scale it up to reach the terminal capacity of 500 MT by the end of 2012. That is all from our side, would be happy to take on any questions.

Basudeb Banerjee, Quant Capital What was the overall volume growth for India Operations and at a consolidated level?

Gaurav Kumar It is not possible to provide consolidated volume growth because in Europe we do not measure the output in terms of tonnage. And, growth in terms of units is not a relevant indicator due to different categories and sizes of tyres. In India, the volume growth was around 4%.

Basudeb Banerjee At a consolidated level we can see employee cost moving up by Rs 860 million sequentially, whereas at standalone level it is up only by around Rs 150 million. Any one-off wage hikes in South Africa or Europe Operations?

Gaurav Kumar There is no one-off in this quarter. In the previous quarter, there was reduction in staff cost on account of one-off adjustment relating to pension related benefits. The reductions in pension liability get routed through the P&L, resulting in reduced staff cost. That is the reason for a big increase being visible in this quarter but this is a normalised level of staff cost.

Basudeb Banerjee But at a consolidated level, this level of absolute number will continue in coming quarters as such?

Gaurav Kumar Yes, a similar number will continue going forward.

Basudeb Banerjee And what was the growth in Euro terms for Vredestein?

Gaurav Kumar There was no topline growth in Euro terms for Vredestein.

Basudeb Banerjee So this 8% is primarily in rupee terms?

Gaurav Kumar That is correct.

Jaybir Sethi, CLSA Just wanted to understand 2 things a little better. First, you mentioned that there have been some price hikes and mix improvement in Europe, which have driven this margin performance. Now, looking ahead, seasonally this is supposed to be a relatively weak quarter. So, on a full year basis, do you expect margins to be actually better than what you have delivered this quarter for Vredestein?

Gaurav Kumar Jaybir, we would not want to give out margin guidance. Agree that historically June quarter is not our best quarter. We do better in September and December quarters; depending on the intensity and duration of the winter season**.**

Jaybir Sethi Any specific product lines which you have introduced or which have particularly picked up and driven the gains?

Gaurav Kumar Nothing specific. The company continues to make product improvements and introduce new sub-brands etc. The market has been down by 15%. So we are proud of the fact that the company has been able to maintain margins. While the company lost volumes marginally, it was made up by the product mix improvements which, remain key and will continue to be an area of focus.

Jaybir Sethi With regards to demand in India, particularly on the replacement side, things have been soft for more than a year now; and at least from your commentary it seems that the things are picking up a bit. Could you shed some light on how things are on the ground, particularly, on the replacement side?

Gaurav Kumar In the current year, we have seen some growth in the replacement segment across various product categories. As of now we don't have the ATMA numbers to be able to give you volumes. But, mid to high single digit growth, in both truck-bus and passenger segment, is what we estimate.

Jaybir Sethi You expect similar level of growth to sustain?

Gaurav Kumar That is correct.

Jay Kaale, Violet Arch What was the Carbon Black and Natural Rubber cost for this quarter?

Gaurav Kumar The average price for Natural Rubber was Rs 210/kg and Carbon Black was at Rs 85/kg.

Jay Kaale And Tyre Cord Fabric and Synthetic Rubber?

Gaurav Kumar Rs 255/kg and Rs 190/ kg respectively.

Jay Kaale And what would be the contribution of exports in the standalone revenues?

Gaurav Kumar Exports contributed just about 10%.

Jay Kaale So, in your standalone revenues, the mix would be 60-30-10 between replacement, OEM and export?

Gaurav Kumar That's right.

Hitesh Javeri, Birla Sunlife

Could you speak about Rubber sourcing? How much ahead of the requirement do you buy and in case of softening of the prices, when do you actually realise the benefits from it?

Gaurav Kumar

For the overseas Operations, the Natural Rubber contracts are on a quarterly basis; so the price impact flows in with a lag, of about a quarter.

For Indian Operations it is a mix of sourcing from India and overseas. Apollo would typically have an inventory of about 3 weeks and the Indian prices are all spot. The impact, in terms of Rubber consumption flowing into the P&L, would be with a lag of just 3 weeks.

About 15-20% of the Indian Operations' requirement is sourced from overseas which, would again be subjected to a quarterly contract.

Hitesh Javeri

What is the outlook for the debt-equity ratio on a consolidated basis for March 2013 and if possible March 2014?

Gaurav Kumar

A difficult projection since, the debt figure is dependent not only on Capital Expenditure but also on profitability. What one can say is that given minimal Capex this year and profitability outlook, Apollo would bring down the leveraging by the end of this year.

Ajay Nandanwar, UBS

What would be your planned Capex in India and internationally for FY13 and FY14?

Gaurav Kumar

As of now, the company hasn't looked at too many growth programmes, since clarity was required on which direction the balance sheet is headed.

The 2 capital expenditures which are close to getting implemented are as follows. One, conversion of truck-bus cross ply capacity in the Kerala plant, which has a capacity of 100 MT/day, into industrial and speciality tyres or off highway tyres (OHT). Currently, about 25 MT has been converted into OHT and over the next one year we hope to convert it entirely to OHT. But again, the timeframe for that has not been fully firmed up. Two, installation of a new mixer in the European manufacturing unit. Right now, while the European Operations have capacity downstream, they still outsource some of their upstream rubber compound because of capacity constraints. This is a small investment of about Rs 1.3 billion.

Ajay Nandanwar

What about the Kerala Capex?

Gaurav Kumar

The Kerala Capex would be about Rs 2 billion but the time frame for this expenditure has not been fixed as yet.

Ajay Nandanwar Apart from these 2, what would be your normal maintenance Capex?

Gaurav Kumar The normal maintenance Capex, for all 3 Operations combined, would be at about Rs 2 to 2.5 billion.

Ajay Nandanwar And how about your European expansion plans?

Gaurav Kumar As of now, Apollo is more or less ready with the project costing, the timeframe of implementation etc. But the company would want to wait a little, given what the European economy is going through, before taking a core decision.

Ajay Nandanwar But your land, approval and other regulatory procedures are all done?

Gaurav Kumar The company has selected a site and has more or less firmed up the discussions, but has not gone ahead for any regulatory approval. So, even from the time a go ahead is given, paper work, regulatory approvals and agreements etc. would take about 8 months.

Ajay Nandanwar You mentioned that in Europe, your product mix has improved. In Q1, do you sell winter tyres as well as summer tyres?

Gaurav Kumar In Q1, we primarily sell summer tyres. There is very limited sale of winter tyres towards the end of the quarter, that too in case some of the dealers want to start stocking winter tyres early. The large volume sale of winter tyres starts from the September quarter, with demand till the December quarter, depending on how the winter season actually is.

Ajay Nandanwar But do you expect similar product mix improvement in winter tyre segment as well?

Gaurav Kumar Difficult to say.

Ajay Nandanwar One of your competitors, Nokian in Europe, is looking to shut some capacity and they are adding capacity in Central Europe. Is that driven by cost reasons? Why would Nokian cut capacity in Europe?

Gaurav Kumar The overall Europe market is down, so that is obviously stressing out manufacturers. Larger the operations, greater is the stress in the system.

In case of Nokian, it seems to be primarily driven by cost factors. Even players like Michelin and Continental, in the past, have used challenging times as an opportunity to close plants. Nokian has set up capacities in Eastern Europe, particularly Russia, which allows them higher profitability.

Ajay Nandanwar Regarding your expansion plans in Hungary or Poland – do these countries fall in the relatively lower cost geography as well?

Gaurav Kumar Hungary and Poland, which are the 2 shortlisted countries, would be fairly cost competitive and that is why a lot of global majors have set up shop here in recent times. One would tend to think that as we continue to move towards the east, cost could be lower; but, in terms of our own ability, we have a detailed set of criteria, of which cost is an important factor, but there are other equally important factors to be considered as well.

Ajay Nandanwar During the rest of the year if your mix of OEM in the truck segment is higher, would that impact your profitability going forward?

Gaurav Kumar We expect it to improve going forward. Right now, the percentage share of OEM is higher in the truck-bus radial (TBR) segment because the radialisation is being driven by the OEMs. Currently, a very large proportion of our TBR tyres continue to be sold to OEMs. This has an impact on the margins but it is expected to be corrected over time.

Naga Deepika, Capital Market What is the standalone net profit for the quarter?

Gaurav Kumar Net profit for the Indian Operations was Rs 753 million.

Naga Deepika You are apparently looking for expansion in South East Asia, Australia and Brazil. Do you think it is the right time to expand into these market and how confident are you of doing that?

Gaurav Kumar The expansions mentioned are marketing expansions. These are not capacity expansions. The company is setting up offices and placing people on the ground in some of these geographies, because these are being targeted as significant export market. This will help in understanding the market better and then plan future growth. We had taken a similar route in the Middle East as well.

Naga Deepika You talked about the Chennai facility ramp up. Since most of the capacity is supplied to OEMs, do you think the company is slowing down the ramp up because of a demand slowdown in the OEM market?

Gaurav Kumar The ramp up and capacity cannot be slowed down, since the bulk of the equipment has been ordered. By the end of this year, the plant capacity will be reached. Though if the demand slows down, production may not happen. As of now, a cutback in production is not envisaged, but if the OEMs slowdown further or if there is a change from the current outlook on replacement, then production cuts may be considered.

Chirag Shah, Enam In the truck-bus segment what is your replacement-OEM mix?

Gaurav Kumar The figure is not readily available, but it is expected to be around 75 replacement and 25 OEM.

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Chirag Shah You had indicated that your replacement demand is picking up.

Gaurav Kumar That is correct.

Chirag Shah But what are the ground level indication you are getting on that? The indication that we are getting is that there could be a further slowdown in the replacement demand, given the low freight availability etc. So can you shed some light on what factors are indicating a pickup in replacement demand or what has happened in last 2 or 3 months?

Gaurav Kumar Apollo's marketing team believes that in the replacement market, the situation is better than last year.

Chirag Shah That could also be due to weak monsoon this year?

Gaurav Kumar The monsoon part of it would get factored in only in the 2nd quarter -- the June quarter. One reason could be that a significant slowdown in OEM growth, in the short term, led to existing vehicles running more, resulting in better demand in the replacement market.

Chirag Shah And on the European side, was there any benefit on currency that you have got on the raw materials?

Gaurav Kumar European Operations have not benefitted from currency fluctuation. But, they have definitely benefitted from decline in raw material prices; unlike India which was hit by rupee devaluation.

Chirag Shah The European Operations did benefit from rubber price decline?

Gaurav Kumar That is correct.

Chirag Shah And would it right to assume that the entire benefit is yet to flow in, so there could be some further margin improvement on account of raw materials price decline?

Gaurav Kumar Raw material prices are expected to remain stable going forward.

Jasdeep Walia, Kotak Securities Could you elaborate more on the mix change that you have seen in Europe, in the first quarter, that has led to higher than usual margins?

Gaurav Kumar When we say favourable product mix, 2 things could have happened. European Operations could have sold more numbers in higher sizes or sold more ultra high performance tyres than normal tyres. It would be difficult to give a break-up of the product mix.

Jasdeep Walia Your inter segment sales number has increased to around to Rs 800 million in this quarter from Rs 440 million in Q4 FY12. Any specific reason for that?

Gaurav Kumar The company has spoken about supplying Apollo branded tyres from India to Europe; supplies of the same have doubled compared to the same period last year.

Jasdeep Walia What would be the outlook for Apollo branded tyres in Europe?

Gaurav Kumar Continued and substantial growth is expected. Europe continues to be our best export market. Also, given the profitability in the European Operations, it makes sense to penetrate further, armed with a dual brand strategy.

Jasdeep Walia And what would be the capacity utilisation of Apollo Vredestein?

Gaurav Kumar Apollo Vredestein has continued to operate at full capacity in the last quarter.

Jasdeep Walia We do not see any advertising from Apollo in the domestic market, given that car tyre market is going to get important in the future. Your competitors advertise quite heavily versus your company. What is your thought process on that?

Gaurav Kumar Apollo Tyres is in the process of finalising a new advertising campaign and it will be launched later this month.

Radhakrishnan, IIFL The interest cost has declined in this quarter whereas the capitalisation has increased. Any reason for that?

Rakesh Dewan, Apollo Tyres It has decreased marginally.

Radhakrishnan And there is some change in reporting also – the figures of last June quarter seems to have been revised.

Rakesh Dewan This is mainly because of the revised Schedule VI that has been recasted. There may be a little impact, of about 84 million, which affects the interest cost. It is largely because of certain items, which were earlier clubbed under other expenses. Now, these have been taken under finance cost.

Radhakrishnan Can you give any broad guidance, on what could be the interest cost for the full year? I think you will not have any more capitalisation.

Gaurav Kumar For Chennai, some capitalisation will continue. As mentioned earlier, the unit has crossed a tonnage of 350 MT and is expected to reach a capacity of 450+. So there would still be some capitalisation that will continue to come through the years.

Radhakrishnan And can you just give me the effective tax rate also possible for this year, for domestic as well as consolidated operations?

Rakesh Dewan Tax rate for Indian Operations will be in the range of 31%. On a consolidated level, it would be about 28%.

Radhakrishnan Last quarter conference call you mentioned that this year you are expecting topline growth of 20%. What is the thought process now?

Gaurav Kumar The growth would be a little muted. Europe growth was not expected to be a challenge. As of now, the company does not expect any volume growth in Europe. South Africa will make up for it hopefully to some extent. Indian market, if it remains the way it is, topline growth of 20% may not be possible; could be a little lower.

Anurag Randev, PUG Securities My question pertains to the current demand scenario in our industry, especially on the OEM side. Secondly, what is the radial contribution to your overall truck-bus product portfolio?

Gaurav Kumar None of the OEMs are indicating any significant pick up for the full year. So, the demand would essentially be led by replacement. Overall, for the truck-bus segment, Apollo is still expecting a growth; given that it is a predominantly replacement market product. One could expect may be a low-to-mid single digit growth, overall, for the segment. TBR's contribution is about 15% to the company's overall revenue.

Anurag Randev Has increase in radialisation already started impacting cross ply tyre market or will it take more time to have any major impact?

Gaurav Kumar There is a slight decline in truck cross ply. That is also impacted by the fact that the growth rate last year was negative and even this year is lower than the historical average. If the growth rate had been at the historical levels, there would not have been any decline. Going forward, there may be some decline in demand, which is why the company has taken steps to convert some of its truck-bus cross ply capacity to specialty tyres.

Anurag Randev In the passenger vehicle segment, 50% of the demand comes from OEMs, where we are seeing a significant decline. What is the demand outlook going forward?

Gaurav Kumar The OEM offtake is under pressure. But, the replacement demand continues to be good. However, the segment growth is significantly lower than the historical levels of double-digit growth.

Anurag Randev We have reached 350 MT of capacity at the Chennai plant. Can you give us a break-up of this 350? How much will be contributed by passenger car tyres and how much will come from TBR?

Gaurav Kumar At a very broad level, out of this 350, about 275 would be TBR capacity and 75 would be passenger car.

Anurag Randev And my last question is on the CCI enquiry. If you would like to comment on that?

Gaurav Kumar We would prefer comment only after the judgement is given and we have had time to study it.

Hemang Tapase, Canara Robecco Can you shed some light on the specialty tyres demand in India?

Gaurav Kumar At least the existing units, that have been set-up till now, are primarily geared for exports. Demand numbers aren't available because it is a very broad category, with segments like forklift, golf cart, lawn mowers etc.; where the number of SKUs and products is much more than truck-bus or passenger car.

Hemang Tapase How much would be the capacity of the Kerala plant?

Gaurav Kumar That plant has a capacity of around 100 MT/day. Right now about 25 tonnes has been converted into specialty tyres.

Bharat Gianani, Share Khan There is some proposal from the Government to increase the duty on Carbon Black imports from China. What is your take on that and will it impact your material cost side?

Gaurav Kumar Will not be able to comment on Government's proposal to increase duty on Carbon Black. If that goes ahead, it may lead to an increase in raw material prices to the extent that we source it from China.

Bharat Gianani But from the overall industry side, can you share a number? Like what proportion of the Carbon Black imports for the tyre industry come from China?

Ritu Kumar, Apollo Tyres As of now, the import of Carbon Black is insignificant. Mostly, it is procured from the domestic market.

Nisarg Vakharia, Lucky Securities I am again referring to the European Operations. You mentioned that you got an 18% EBITDA margin versus 13.5% last year. Is that sustainable?

Gaurav Kumar Difficult to say. Historically, if you look at the averages, 18% is high. The company has hit 18%+ mostly in winters. In a stable raw material scenario, 18% may be achievable.

Nisarg Vakharia And has softening of raw material prices also been included in this 18% margin as of now?

Gaurav Kumar Yes.

Nisarg Vakharia On Capex, what I can understand is that you have approximately Rs 4 billion of spend this year, including maintenance Capex. Is that a figure that we can safely assume or you might look at doing more?

Gaurav Kumar That is a figure you can safely assume. There will be some Capex on account of Chennai completion and the balance would be maintenance Capex.

Disha Shah, Anvil Stock Can I know the margin difference in radials and cross ply in case of truck-bus?

Gaurav Kumar Right now, the margins would be similar. The TBR capacity is still in the ramp-up phase. Moreover, in a plant, which is ramping up, there are other manufacturing costs in terms of wastage and scrap levels etc. and also the manpower cost typically tends to be higher. In a stable case, the radials may be about 1% higher up on the profit margin but, it will depend on the pricing differential. As of now, there is no evidence to say that radial would generate a higher margin.

Disha Shah And what can we expect on an incremental ROCE from Chennai plant?

Gaurav Kumar Difficult to answer how much incremental ROCE can be expected. The ROCE will continue to improve because right now the Capex spend is ahead of the revenue.

Disha Shah And can you update me on the anti dumping duty on Chinese tyres? Is it still there?

Gaurav Kumar It is very much there.

Disha Shah And on the inverted duty structure. There are no changes?

Gaurav Kumar There is no change and none is expected.

Sachin Kasera, Lucky Securities In the segmental number that you have given, the other segment revenues have grown from Rs 33 million to Rs 495 million. Does this represent the sales in the Middle East?

Gaurav Kumar Yes, that would be Middle East and some of the other significant export services. Middle East would be the biggest.

Sachin Kasera And this would primarily be shipment from India?

Gaurav Kumar Middle East is served primarily from India.

Sachin Kasera Secondly, you mentioned regarding converting of the Cochin capacity from cross ply to radial. From a technical perspective, what is the cost implication of this?

Gaurav Kumar The Cochin capacity is being converted from truck-bus cross ply to specialty tyres, which too cross ply. There are no conversions from cross ply to radial, which is why the investment would be marginal. Conversion from cross ply to radial comes at a significantly higher cost.

Sachin Kasera But is it still significantly cheaper compared to putting up a new radial capacity?

Gaurav Kumar Conversion from cross ply to radial would mean incurring almost 80-85% of the full cost. Not much of cost saving there.

Aniket Mhatre On behalf of Standard Chartered Securities, I would like to thank the entire team of Apollo Tyres and all the participants for being there on the call. Wish you a pleasant day.

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