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Investor / Analyst Conference Call

Fourth Quarter of Financial Year 2012-13

Aniket Mhatre, Standard Chartered

Good evening! Welcome to the post results conference call of Apollo Tyres. From the management team we have Gaurav Kumar, Group Head, Corporate Strategy and Finance; Rakesh Dewan, Head, Accounts; and Ritu Kumar, Head, Financial Planning & Control. I now handover the floor to Gaurav.

Gaurav Kumar, Apollo Tyres

Good evening everyone and thanks for attending the call. Overall market scenario for this quarter continued to be tough. We had a negative growth or fairly low growth in various markets be it India or Europe, which impacted the turnover. On the positive side, the raw material scenario was favourable and hence, we did well on the profitability side. The OEM growth in India was still in the negative zone impacting margins & capacity utilisations significantly. Across various markets, we are seeing price pressures in terms of discounting by various competitors off and on and to that extent the low raw material prices through last few quarters are beginning to have an impact on pricing.

On a consolidated basis, sales for the quarter were Rs. 30 billion, 6% lower than the same period last year. However, we had a significant improvement in the operating margin from 11.7% for the quarter last year to 13.2% for the current quarter. Raw material came down by nearly 9%, with rubber and synthetic rubber declining by nearly 15% & 20% respectively.

Overall, for the full year, we recorded Rs. 128 billion in sales, a growth of 5% over previous year. EBITDA margin showed a significant improvement from 10% last year to 12% this year. Combined with the higher profitability, lower capex; net debt declined to Rs. 23 billion with net debt to equity ratio down to 0.7 against 1.0 in the previous year.

The replacement segment went up to 76% from 73% last year as a result of a slowdown in OEM. Product mix continued to be at similar levels, which is 48% for truck and 35% for cars. In terms of an outlook, market continues to be tough. We do not expect growth coming back quickly. For Q1, we see some pickup in India resulting to an upturn in the turnover. The raw materials are expected to be stable to a little higher so that scenario is also fairly favourable.

Moving onto specific operations starting with India - Sales for the quarter were Rs. 20 billion, down by 10% over the same period last year. EBITDA margin improved from 10% to 13%. On a full year basis, sales were Rs. 85 billion, up by 4% over same period last year; contributed through an equal mix of volume and price of 2% each. EBITDA margin for full year improved from 8.5% to 11%.

Net debt continued to reduce in line with the consolidated figures bringing leveraging ratios to a more comfortable level. Replacement proportion went up in line with the fact that the OEM slowdown happened.

Moving onto South African operations - Sales for the quarter were Rs. 3 billion, down by 9% over the same period last year. EBITDA margin for the quarter was 4.5% compared to a slight loss in the same quarter last year. This quarter, there was an exceptional item at South Africa. When we took over the operations, the company had a pension fund surplus. Some of you would recall that a couple of years back a large portion of this pension fund surplus was realised, a significant part of which was sent out to the sellers, as per our understanding with them and the balance was retained by us. We therefore had an exceptional item on this account. A small percentage of this pension fund surplus was retained by the financial services board there to make sure that they re-check all the obligations. That process was completed and the remaining balance, held by them, has been released and hence, there is an exceptional gain that is coming in. Again, as per the agreement with the sellers about half of it went out to them and half of it came into the company. So on a net profit basis the South African entity was significantly positive, but that is a one-off. For full year, South Africa recorded Rs. 15 billion in sales with a growth of 15% over last year. EBITDA margin was at 4% compared to a much lower number last year.

Moving onto the European operations – Europe also faced a very tough environment in 2012 which continued in the first quarter of 2013. The new car and truck sales are down 20-30%. GDP continued to be negative. In Q4 the market was down by 12% whereas our European operations were down only 2-3%. However, profitability continued to be good due to raw material and product mix improvement. Sales for the quarter were Rs. 7.3 billion, a growth of 8% over the same period last year. EBITDA margin improved to 17.6% from 16.8% for the same quarter last year. On full year basis, sales were nearly Rs 30 billion, up by 5% over last year and EBITDA margin for the full year improved to 18.3% from 15.8%. Working capital also continued to come down both on a consolidated and standalone basis which further improved leveraging position. That is all from Apollo Tyres - Would be happy to take your questions.

Supriya Madye, HSBC

What is your current capacity in car and truck segment in India and overall?

Gaurav Kumar

In India we have a PCR capacity of about 32,000 tyres a day, truck radial capacity of about 5,500 tyres a day and truck cross-ply capacity of 10,000 tyres a day. In our overseas operations, South Africa has a capacity of about 10,000 PCR and about 1,100 truck radial tyres a day. In Europe, we have a capacity of about 18,000 PCR tyres a day.

Supriya Madye What is the demand scenario in the replacement market and the status of your market share?

Gaurav Kumar The demand has been slightly positive. Since, we are not getting the ATMA data; we do not have the market share numbers. We believe that we have gained market share in truck radial and passenger car segments but we do not have authenticated data from the industry association.

Supriya Madye Any price hike taken in the reported quarter?

Gaurav Kumar No price hikes have been taken; it was not warranted given the raw material scenario and industry situation. In fact, we took a price cut of around 1% in the month of March.

Amin Pirani, Deutsche Bank What is the consolidated capex for last year and the expectation for next year?

Gaurav Kumar Consolidated capex for last year was around Rs 6 billion. In terms of outlook for next year; given the slowdown we had a capacity under-utilisation so, we are not looking at any significant capex for now. We plan to do a maintenance capex of about Rs 2.5 billion in India, South Africa and a similar number in Europe. So overall capex would be about Rs. 5 billion or a little higher, but it will continue to be adjusted in line with the market situations. We are going slower than our original plan on the Thailand Greenfield as we want to see the direction in which the market progresses. Right now, we have sufficient capacity in our operations.

Amin Pirani So, Rs 2.5 billion in India would mostly be maintenance capex or is there some capacity expansion?

Gaurav Kumar There is no capacity expansion. With some part of it, we would be converting the Kerala plant from trucks into specialty tyres. There is a capacity convergence and no expansions happening in India.

Mayur Milak, Dolat Capital Other expenses have gone up quite significantly for both standalone and consolidated operations. What could be a significant part of this and do we see this as a regular phenomenon going ahead?

Gaurav Kumar One reason for increase in other expenses is R&D expenses, for it gets reclassified from manpower to other expense. For example, we have opened up a new R&D Company in Netherlands which has also become our global hub for R&D for passenger car tyre. Some part of it was added into manpower but now, all of it comes under other expense; which is the major cause for increase. Also, we did ran a corporate campaign for a number of months.

People would have seen the media and the television advertisement which were also a reason for higher other expenses.

Mayur Milak Higher R&D means that you will have a better tax advantage going forward. Right?

Gaurav Kumar We will have some tax advantages in Netherlands and that will continue. Investment on R&D will continue because we plan to give a lot of thrust on it. As we gain share in the European market, along with our vision of growth in other global markets; these expenses will be higher than previous years where we were serving limited markets.

Mayur Milak Does it also means that spend on advertisement campaign will also continue to be highest?

Gaurav Kumar That will be a one-off but yes, we will spend reasonable amount on advertisement and promotions. We realised that, while we were well known regionally and in specific areas; the car tyre segment specially needs much more corporate branding and advertising compared to truck.

Mayur Milak So as a percentage of revenue, do we expect them to really go significantly higher than what you have reported as of now?

Gaurav Kumar In case of both R&D and marketing expenses, the fact that top lines are increasing would take care of any disproportionate increase vis-à-vis increase in revenues

Mayur Milak Does other expenses also include any kind of discounts that you would have given to gain additional market share in the replacement market?

Gaurav Kumar Demand situation continues to be dynamic and sales people have to react to competitive pressure. So it is not something that can be confirmed that it will continue. It is always done on a case to case basis looking at the market situation. As of now in Q1, we will definitely continue to see such kind of activities from markets around the world.

Mayur Milak We have seen rubber prices coming off significantly and going forward, we expect commodity prices to soften or continue to remain at where they are. Has the high cost inventory already been taken care of or do we see further benefits coming in the following quarters?

Gaurav Kumar High cost inventory has already been taken care of particularly, natural rubber as it has been around these levels. Over the last few weeks, it has been between late 150s and mid 160s and has gone slightly up in the last few days. As per our expectations raw material would be similar to slightly up. We don't see further raw material decline from the levels of Q4, at least in the near term.

Mayur Milak What has been the capacity utilization in all the three units?

Gaurav Kumar Capacity utilisation in India is about 75%, Europe at about 85% and South Africa has been nearly at 70% levels.

Sumanta Khan, ICICI Prudential Life If I look at the standalone tax rate, depreciation in the subsidiaries and the other income for this quarter, these three things are slightly different from normal rates. Tax rate in stand alone is slightly higher. Depreciation in the subsidiaries is also higher. So is there any one-off out there or is it just averaging out the entire phenomenon?

Rakesh Dewan The higher tax rate for India in this quarter, effectively about 40% is because of the increase in surcharge rate from 5% to 10% in this budget. But this is a one-off, negatively impacting the measurement of deferred tax liability for this quarter. The effective tax rate for India has gone up to about 34% on a full year basis, even though quarterly impact is high. The effective rate going forward would be 33.99%

Coming to the other income, the increase is mainly due to an increase in foreign exchange fluctuations, certain write-offs and also includes certain recoveries.

Sumanta Khan For the full year other income number for consolidated is around 94 crores, do you think that is slightly on the higher side? Should it be around 80-85 on a sustainable basis?

Gaurav Kumar If you knock off the following two big items namely; recovery and the insurance claim of Rs. 80 million last year, you a get a more regular value.

Sumanta Khan If I just subtract the depreciation for the consolidated from the standalone, roughly the rate I get is around 37 to 39 crores on a quarterly basis. And this quarter the number that I am seeing is around 64. So I was just wondering should I increase my run-rate or should I go back to the same 40 level?

Rakesh Dewan One cannot simply add the depreciation of subsidiaries and then match with consolidated figure because it is having an impact of various GAAP adjustments and accounting standards. When we convert IFRS financial statements to

Indian GAAP financial statements there are certain adjustments that are carried out. You cannot simply add the depreciation of all the entities and match it. Further, there has been an impairment of certain fixed assets which has also impacted the depreciation.

Abhijeet Bora, IFCI Financial Service Has the government ratified its proposal to increase the import duty on Natural Rubber and do you gain anything from the natural rubber imports from countries like Thailand in light of FTA signed with them?

Gaurav Kumar There is no official confirmation about the hike in natural rubber duty. As of now, our import content of rubber is not significant. It varies from quarter to quarter because our purchase team takes a call based on the international and domestic prices as to what makes greater business sense for the company. If the proposal comes through, raw material prices will move up and to that extent one has to either take care of it in sales price or see how options can be found to increase the local content. Also natural rubber is not included in the list of duty free items under FTA with countries like Thailand, Indonesia etc.

Abhijeet Bora What is the proportion of imported rubber and how much is purchased from India?

Gaurav Kumar It changes from quarter to quarter but on an average for Indian operations it is about 80% domestic and 20% imports.

Mahantesh Sabarad, Fortune Equity Given the weak demand scenario in India and Europe and considering you are among the market leaders, do you see a large drop in the share of business among OEs compared to the competition?

Gaurav Kumar We do not think that we have had a bigger fall than others. If it is one particular OEM we have a larger share with and that OEM is down then yes, it will impact us more than the others. But I do not think there is any significant change in our OEM shares; so, we did not have any drop in terms of OEM market share. However, significant decline in OEM demand have had an impact on our capacity utilisations being down to around 70%.

Mahantesh Sabarad How are you witnessing the trend in India in terms of replacement demand?

Gaurav Kumar We are seeing some pick up in the demand so, the outlook for Q1 is better than Q4. Last year, replacement was far lower than the historical past, but both truck and passenger car replacement showed positive growth. It is just that the extent of OEM decline was so severe particularly in case of truck that the overall segment declined. Situation looks to be better this year. However, on the OEM front it is still being talked that the recovery may come in the second half.

Mahantesh Sabarad How do you see the strengthening of Yen affecting rubber prices in India?

Gaurav Kumar We have not seen Yen impacting the rubber prices in a major way. However it is fairly complex equation to say how the actual physical market of rubber, the demand supply and speculation in commodity market impact each other.

Radhakrishnan, IIFL Can you provide the details of tax expenses adjusted for net of MAT credit for the previous periods?

Rakesh Dewan We were under MAT for almost 2-3 years which implies that MAT credit is available as recoverable asset in the balance sheet. We have utilised MAT credit of about 100 million this year from our tax liability.

Radhakrishnan Does this mean that if this MAT credit would not have been there then the tax expense for the consolidated operations would have been 91 crores?

Rakesh Dewan No, it would have been the same. The impact would go to the recoverability in the balance sheet.

Radhakrishnan Indian operations registered a 10% decline in Q4, how much is from volume and how much is from realization for the quarter?

Gaurav Kumar The entire decline is from volume.

Jasdeep Walia Kotak Could you give us the trends in volume and price mix for all geographies during the quarter on a YoY basis?

Gaurav Kumar In India the entire decline of 10% was from volume. In South Africa where we had a 5% growth, it was 3% from volume and 2% from price and in Europe where the number was marginally up, it was 3% up on volume and almost a similar amount knocked off on price to pick the revenue up by 0.5%.

Jasdeep Walia What are the raw material prices for the quarter?

Gaurav Kumar The average Natural Rubber price was Rs. 180, Synthetic Rubber at Rs. 140, Tyre Cord Fabric at Rs. 230 and Carbon Black at Rs. 78 per kg.

Jasdeep Walia Has the increase in rubber import duty been notified by the government?

Rakesh Dewan This has still not been notified by the government. According to a news article yesterday, the revenue ministry has not yet approved the notification.

Jasdeep Walia Do you include any other income in the European EBITDA margins?

Gaurav Kumar There is no other income in Europe whether last year or this year.

Chirag Shah, Axis Capital What was your revenue in Euro terms for the European operations in Q4 this year and last year?

Gaurav Kumar Euro revenues were 102 million in Q4 this year and it was a similar number last year.

Chirag Shah How has the currency fluctuations affected you in the quarter as your top line also seems to be higher YoY but margins on YoY basis are down?

Gaurav Kumar That would be a currency effect. As I told you in Euro millions, the revenue is flat and which is why when we talk of the margins, revenue, etc. we talk of them in local currency so that it is a true operating result making out any currency effect.

Chirag Shah What is your current South Africa capacity in terms of tyres per day?

Gaurav Kumar Car tyres capacity is 10,000 a day, truck capacity is about 1,100 tyres a day and then there are other smaller product categories.

Chirag Shah And in India what would be your car tyre capacity?

Gaurav Kumar The car tyre capacity in India would be about 32,000 tyres per day.

Chirag Shah You indicated that the utilisation levels in India are about 75%. Would that be driven largely in the truck side?

Gaurav Kumar Both the truck and the car tyre capacity utilisations have been going down. I do not have exact number as to which one is at what level.

Chirag Shah And just a question on truck radialisation, is there any change off late that has been seen given the way economy is performing? Has the shift towards radial tyres in the replacement side slowed down?

Gaurav Kumar We have not seen any impact on radialisation coming in. May be there is a shift of one odd percent but it has reached a certain momentum and continues to do so. We are still seeing an increase of 4% to 5% in radialisation as an overall percentage year-on-year which does not seem to have changed with this slowdown.

Chirag Shah According to you what could be the radialisation number, percentage wise for FY13?

Gaurav Kumar Vinay, you have the number?

Vinay Sadana It would be about 25%.

Basudev Banerjee, Quant Capital

Taking this scenario forward, you have 12-months timeline for going through QIP. So what can one take out from your plans presently?

Gaurav Kumar

Given the markets equation and the capex position, we would not be raising money through the QIP route and hence, its approval which is valid up to November '13 would just lapse.

Aditya Makharia, JP Morgan

You mentioned that this year the replacement side seems to be better. Could you throw some numbers whether you are seeing a slight or a sharp pickup?

Gaurav Kumar

We are not seeing a sharp pickup but what I hear from our sales team is that we should expect an increase in sales primarily, driven by the replacement side.

Deepak Jain, Shubhkam Ventures

This 1% price correction was across the board or any segments which are more impacted?

Gaurav Kumar

It is not across the board. We took around 2% price correction in PCR and 0.5% in bias category. We did not take any price correction in TBR.

Deepak Jain

Can you give the EBITDA margins for 3Q for Europe in local currency as it has been your best quarter?

Gaurav Kumar

The margin last quarter was about 20%.

Vishal Saraf, SBI Mutual Fund

Just wanted a clarification on the previous point you were mentioning on the price cuts, this 2% in PCR you mentioned, this is a price cut you took in March, is it?

Gaurav Kumar

Vinay, can you give the effective date?

Vinay Sadana

This was effective 15th March.

Vishal Saraf

And any price cuts you have taken post that?

Vinay Sadana

No price cuts post that.

Vishal Saraf

For the truck radials you have not taken any price cut over last three to six months at all, is that correct?

Vinay Sadana

Correct.

Vishal Saraf	And is this true for both OE and replacement markets?
Vinay Sadana	This is only for replacement market.
Vishal Saraf	And in OE markets have you taken any price cuts?
Gaurav Kumar	We would not have the exact details but with some OEs, there is a price formula that is agreed and if that being the case, as raw materials have come down there may have been some reductions off late. I do not have exact details as to how the pricing works with particular OEMs. So, no across the board price cuts have been announced but if with any of the OEMs we are on a regular price adjustment mechanism then it will move up and down quarterly, in line with raw material.
Vishal Saraf	Just wanted to understand the average cost you had mentioned earlier, about Rs. 180 for rubber. Currently on exchanges the number looks like 15% lower than this, so does it include duties?
Gaurav Kumar	The number that I gave is our final consumption price so it includes everything which is freight, any kind of duties, etc. And when we talk of 180, you can safely assume that the basic rubber price would have been in the range of 165.
Vishal Saraf	So this will be similar to the current rubber price. So even now in first quarter rubber prices would again be similar to Rs. 180?
Gaurav Kumar	Should be similar unless in the next 45 days there is some significant movement up or down.
Vishal Saraf	And how have the prices for other raw materials been off late?
Gaurav Kumar	As I mentioned, synthetic rubber is about Rs. 140, down by 20%, Tyre Cord fabric at Rs 230, down by 10% and carbon black was at Rs. 80, up by about 4%.
Nishant Vass, ICICI Securities	Would it be possible for you to quantify the capacity in tonnage terms also?
Gaurav Kumar	I do not have the capacity in tonnage terms for Europe because they do not measure it as we have explained in some of the previous calls. South Africa capacity is about 175 MT per day across the two plants. For India, with Chennai capacity totally coming in it would be around 1400 MT per day.
Nishant Vass	Continuing on the question - you just said the utilisation in the domestic business is around 75%, I just want to put a hypothetical question – in case utilisation improves and the cost remains low, could we go back to FY10 level of margins? Is that a possibility or you would like to have a cap on margins?

Gaurav Kumar We definitely would not want to have a cap on margins. If the market situation permits we would want to go even higher.

Nishant Vass Okay, so you could have FY10 kind of a situation.

Gaurav Kumar Sure, we would love that.

Nishant Vass Just wanted a view on the tax rate for the consolidated business. What would be a fair estimate for the consolidated business tax rate?

Rakesh Dewan Tax rate at consolidated level would be in the range of 31-32% going ahead.

Jay Kale, IDFC Securities Just wanted a breakup of replacement, OEM and exports for this quarter for India and consolidated operations?

Gaurav Kumar For India the replacement was about 60%, OE 30% and the balance was export. On a consolidated basis, it was 76% replacement and 24% OEM.

Pramod, CIMB India Given the slowdown in the market and the cost pressures, how have you seen the Chinese imports as a percentage of overall volumes in the country? Have they gone up or have they been stable?

Gaurav Kumar For the full year, Chinese imports of truck radials were down 20%, they were at about 600,000 in FY12 and at about 470,000 in FY13. On the passenger car side they have gone up by about 10% from 4.7 million in FY12 to 5.2 million in FY13.

Pramod This seems a bit counter-intuitive because the cost pressures would be much higher on the truck replacement side for fleet owners, so how do you explain this 20% drop here and a 10% increase in passenger vehicle?

Gaurav Kumar I can only give you a hypothesis because there is no proven statement out there. On the truck side, there continues to be quality issues, so there are Chinese players who are improving while some of the Chinese imports are still having issues with anti-dumping duty. One big change this year was rupee depreciation of 10% which may have impacted the Chinese imports. On the passenger car side, it continues to be more at the higher end and the small well-known brands. So the passenger car imports are not driven by the Chinese side of it and along with the top-3 players which is Bridgestone, MRF and Apollo, imports now are almost an equal player. So you could call it as dominated by four players and one of them is imports.

Pramod On the SUV tax, because there have been a lot of talks about OEMs reducing the ground clearance as one of the way to come outside the 30% tax bracket and I think one of the ways to do that would be downsizing the tyre sizes. What could be the implication if they choose it that way?

Gaurav Kumar There would be some adverse impact on the mix if it comes in. But then if there is more demand for the lower size tyres the price of that would move up.

Aniket Mhatre On behalf of Standard Chartered I would like to thank the senior management team of Apollo Tyres for taking their time out and patiently answering all the questions.

Gaurav Kumar Thank you everybody for being on call with Apollo Tyres.

(ends)