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Analyst / Investor Conference Call

Second Quarter 2013-14

Aniket Mhatre,

Standard Chartered

Good morning! 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 of Accounts; and Ritu Kumar, Head of Financial Planning and Control. I would now hand over to Gaurav.

Gaurav Kumar

Good morning everyone. Welcome to our Quarterly Earnings Call

I would begin by recognizing that many of you would have questions relating to the Cooper transaction news, which has been fairly active in the media with the recent legal case.

Unfortunately due to the situation, we would not be able to take any questions relating to the Cooper transaction and hence I would request you to hold off your questions on the same, otherwise our answer would continue to be 'no comment' at this stage till we have complete clarity on that.

On a consolidated basis: sales for the quarter were at Rs.34 billion plus, a small growth of 2% over the same period last year. Growth continued to be impacted because of the industry situation in India. The EBITDA margin for the quarter was at 12.8%, an improvement over the same period last year at 11.3%, aided by the raw material cost which compared to the same period last year declined by 8%.

In terms of revenue break up, 81% of our revenues came from the replacement market and the balance from OEM. The two main segments – truck and passenger car contributed 42% and 40% respectively to the

revenue for the quarter. The net debt figure at the end of the quarter was at Rs.23.5 billion and a net debt equity ratio slightly under 0.6.

Current quarter expenses were also impacted by one time transaction expenses. The total expenses that have been incurred are of the tune of Rs.1 billion, out of which Rs.0.7 billion are related to financing and are amortized over the financing period and the balance Rs.0.3 billion has been charged off in the current quarter.

In terms of the outlook on the raw material, we expect it to be stable going up by a small couple of percent in the next quarter.

Moving on to individual operations starting with Indian operations – sales for the quarter were at Rs.21 billion down by 8% compared to the same period last year. The decline was entirely coming through volumes with a very small decline in the price and mix. The EBITDA margin for the quarter however improved significantly coming in at 13.5% compared to 10.3% for the same period last year. For the first half revenues were down by 4%, again impacted by the industry situation. The net debt continues to be at lower levels at Rs.17.5 billion. Also in terms of revenue segmentation, the OE proportion is significantly lower - down to 23% given the state of new vehicle sales.

Moving on to South African operations - sales for the quarter were at Rs.3.7 billion, a decline of 5% over the same period last year. The EBITDA margin was 5.7% with a break even at net profit level. Regarding our transaction with SRI, the last of the conditions precedent have been fulfilled just a few days back and hence we will now be going towards the transaction closure at the end of November-2013 which would mean that from December-2013 onwards our South Africa operations would only comprise one plant in Durban.

Moving on to European operations – sales for the quarter were at Rs.10.1 billion, a significant growth of 27% over the same period last year. A large

amount of growth came through volumes and exchange rates but nearly 15% growth of top line came through volumes. While the European market grew by only 4% in the current quarter, Vredestein had a volume growth of nearly 15%. However the competitive situation and the industry scenario meant that a significant price reduction had to be taken due to competitive pressures which led to EBITDA margin coming down at 15.1% compared to a margin of 17.0% last year.

That's all from our side. We would be happy to take your questions.

Pramod Kumar

IDFC Securities

My first question pertains to the standalone business. Given the slackness in CV sector which is also getting reflected in your revenue numbers for the last 2 – 3 quarters now, how would you see the segmental mix moving going forward for commercial vehicle and passenger vehicle and within that OEM and replacement and in the recent commentary, all the commercial vehicle manufacturers are in a way indicating that any meaningful recovery could be at least a year away so what would be your strategy to counter this going forward?

Gaurav Kumar

The OEM proportion has continued to come down, if we look at the same period last year which is the September quarter, the OEM has come down from 30% to 23%. Similarly there has been a slight decline in the truck proportion. It's an industry phenomenon, there is nothing much that we can do about it and also as a short term measure one does not have the option to increase exports because developing any new market needs a certain amount of time and a longer term commitment. None of the export market for our industry is something you can get in and get out unless you want to position yourself and your brand as a dumping brand which is not our strategy for any growth market. So in near future, impacted by some of the industry phenomenon, the revenue would continue to be subdued and similarly the capacity utilizations would continue to be at lower levels. We

are somewhere in the mid 70% currently. The plus side of it is that there is very little pressure on margins; the raw material prices with the global scenario continues to be soft. So margins are healthy and the operations continue to deleverage for us, in terms of growth opportunity when it comes on board it doesn't strain the balance sheet that much.

Pramod Kumar So there would not be any meaningful diversification which you will be looking at or seeding any new export market which will probably start playing out in the next 2 quarters?

Gaurav Kumar We are looking at new export markets, we have opened up offices for example in South East Asia in Thailand. But it's not that they would start contributing meaningfully in the next one – two quarters.

Pramod Kumar And I appreciate you guys not answering questions of the Cooper deal subject to the matter being under litigation, but just want to understand how far you have reached in terms of the financing arrangement for the deal?

Gaurav Kumar I would not be able to comment on it Pramod.

Pramod Kumar In case of European operations, how much of the winter demand is already played out in Q2 results? Will there be any meaningful play left in Q3 for the winter demand?

Gaurav Kumar Seasonally the December quarter is our best. It will really depend as to how the winter season is in November but a lot of winter demand does come in the December quarter.

Pramod Kumar You mentioned that volume is good so does it mean that the pricing can improve because you talked about pricing pressure in Europe, can we expect some easing off in pricing pressure in Europe in Q3?

Gaurav Kumar I really do not have data for the industry. I know that Vredestein has done good business in October but was it in line with industry or well above the industry is something that I don't know.

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- Pramod Kumar** With respect to the standalone business, how are marketing, promotion and advertising expenses trending for last one year?
- Gaurav Kumar** They have been increasing; media spent particularly have gone up. So that's one expense that would have definitely taken the overall expenditure on this particular line item up through the last year.
- Pramod Kumar** Is it fair to assume that it will keep on increasing given the sense of increased competition specially led by Michelin as you may need to step up your brand spent and in a way stand up to Michelin as they enter the Indian market. Is it fair to assume that you may not see much of relief on the line item even though demand starts to make a comeback?
- Gaurav Kumar** We would expect it to remain at similar levels and don't expect it to be on a rising trend.
- Pramod Kumar** And it is basically as a percentage of revenue?
- Gaurav Kumar** As revenue goes up, the percentage tends to come down because some of that media spent is fixed in quantum and just doesn't increase because revenue is increasing. Right now it shows up as a higher percentage of revenue because of the market conditions. So as a percentage of revenue it may come down and as an absolute amount it would probably remain at similar levels.
- Pramod Kumar** This is a follow up to the break away fee, just want to understand one thing, even if you are able to prove in the US courts that there was no shortcomings from your side and you did everything in good faith but there were some restrictions from Cooper side related to labor and Chinese joint venture, will you have to still pay the walk away fee?
- Gaurav Kumar** We don't have to pay the reverse break up fee in every circumstance but I would not be able to get into details of this as of now.

Ruchi Vora

UBS	Just wanted some color on the pricing and the demand break up for each market and what's your broad view on each of these going forward from the next few quarters?
Gaurav Kumar	On a consolidated basis, it's about 80 - 20 on replacement to OEM. The proportion for the Indian operations would be about 77 – 23. As of now, the OE proportion would continue to be low in India. We are not expecting a sharp recovery. There is some pick up in the festive season but the OE proportion would continue to be at these lower levels. Similarly from a product category perspective, truck typically is in excess of 65%. So it is about 2/ 3 rd of our revenue, which is down into the low 60% and as of now should continue at similar level. So its not a big change but the truck proportion is down a few percentage points.
Ruchi Vora	Could you also give some color on the pricing and volume break up for each market and where do you expect volumes to go over the next few quarters?
Gaurav Kumar	As of now we would not be able to comment specifically on volumes over the next few quarters. We would expect a flat kind of a top line growth in India which is primarily volumes being down slightly let's say somewhere in the single digit and being made up on pricing or on mix growth. In case of Europe, we expect the volumes to be up but the price vis-à-vis last year to be down; pulling down the top line but it would still be a positive growth.
Ruchi Vora	On the tax rate just wanted to check on why the tax rate is lower in the quarter at 16%?
Rakesh Dewan	It is because of some tax write backs present in European zone. Because we have certain tax liabilities which are no longer required. Tax liabilities of about €3.5 million have been written back during this quarter. As per the Netherland's tax laws, there is certain period which is allowed for tax claims. That period has elapsed and these liabilities are no longer required. So these are written back.

Ruchi Vora	In case of Cooper transaction are there any time lines for the final ruling on the court case?
Gaurav Kumar	We expect something further by end of this week, whether that would be a complete thing or this matter would go on, is something I really don't know.
Ruchi Vora	I understand from reading some of the court exhibits that 15 November was the deadline for Cooper for presenting its consolidated financial documents. I am not sure if you can comment on this, but just want some color if the financing is contingent of Cooper filing these statements?
Gaurav Kumar	The last dates for Cooper to declare its 3 rd quarter results or the September quarter results is 14 th November. Whether financing is contingent on that, is something I cannot comment on.
Pramod Amte	
CIMB	This is with regard to the balance sheet, if I look at the receivables and inventories they seem to have gone up drastically as compared to March levels. What has happened in the market place to take such a drastic measure?
Gaurav Kumar	The reason for increase in inventory is primarily on account of increase in raw material due to production being expected at a certain level, raw material was ordered and the production was lower than that expected level resulting in higher inventory. It's something that will get corrected.
Pramod Amte	The receivables also have moved up almost 30% in terms of number of days.
Gaurav Kumar	I would check on this Pramod because the data I have with the receivables are at flat levels compared to last quarters.
Basudeb Banerjee	Seeing at your competitor numbers in the domestic market like JK tyres where revenue is up 9% year on year a smaller player like Ceat being flat

here year on year, so where do you see Apollo is missing out with revenue being down 8% year on year compared to the peer set?

Gaurav Kumar

I would admit that I don't have an immediate answer to this and would have to come back to you.

Basudeb Banerjee

Quant Capital

You mentioned that Rs.30 crores one off expense was routed through Vredestein this time for Cooper expenses this quarter?

Gaurav Kumar

It was primarily routed through the Dutch holding company, and not Vredestein.

Basudeb Banerjee

Can you comment on this quarter's commodity prices which are used for the corresponding Natural rubber, Tyre Cord Fabric, Carbon Black etc?

Gaurav Kumar

Natural rubber was about 185 Rs/Kg, Synthetic Rubber at about 130 Rs/Kg, Steel Cord at about 115 Rs/Kg and Carbon Black at about 80 Rs/Kg.

Basudeb Banerjee

Are these rates reflecting the magnitude of rupee weakness to any extent or broadly one can expect these kind of levels to sustain on a rupee basis?

Gaurav Kumar

These rates take into account the rupee weakness. The natural rubber prices in rupee terms have come down significantly but overall the raw materials in December quarter, the estimate is that it would be flat to slightly up.

Basudeb Banerjee

Any specific reason why other current liabilities has shot up whereas your long term borrowings have come down. On a total basis, net debt is looking the same but there is some restructuring within the balance sheet?

Gaurav Kumar

The long term debt has continued to go down with positive cash flows. There was certain borrowing in expectation of the transaction closing and that is why the short term borrowings have gone up.

Basudeb Banerjee

Any debt reflected in other current liability which is the repayable debt in the near term?

Gaurav Kumar	There is no such debt
Basudeb Banerjee	In case of standalone operations, on sequential basis the blended realization is up around 3 – 4%, any specific reason for that? Is it due to mix or something else?
Gaurav Kumar	Blended realizations were up by 2% on sequential basis as there were some price increases taken during the quarter and because of the mix impact. Also primarily driving it would be the fact that the replacement proportion is increasing which is higher realization than that of OEM.
Basudeb Banerjee	What would be the percentage of CV mix as of now for standalone operations?
Gaurav Kumar	On standalone basis the CV tyre proportion is 63% for the quarter.
Basudeb Banerjee	And that has been the trend for last several years. So no major change to that. Although absolute quantum of CV tyres has been on a declining trend, still the mix remained at those elevated levels?
Gaurav Kumar	The number used to be higher, for example a year back, 63% would have been around 66 – 67%.
Amyr Pirani Deutsche Bank	In case of European pricing, in the mass market there was always this risk of pricing being weak because of the demand but given the segment that you operate in, is it something which is happening for the first time that you are seeing pricing pressure in your high performance segment as well or this is something which happens in the cyclical basis?
Gaurav Kumar	We are usually not so impacted by the mass market where the pricing pressure is more. But given that the industry in 2013 is still in a decline mode and after a number of quarters, the September 2013 quarter is the first time when the industry had small growth. Also the capacity under utilization from the big players has led to pricing actions and the intensity of the pressure on

prices is significant this time which is never been felt earlier to this degree. Our price mix is down to the extent of about 7% in this quarter.

Amyr Pirani Do you see this continuing at least in the near term?

Gaurav Kumar In the near term that's expected to continue.

Amyr Pirani Can you give us some sense on how the replacement demand is shaping up in India in trucks as well as passenger cars? Is it down to 1 – 2%? Is it in the negative territory or how are you seeing it?

Gaurav Kumar The replacement demand in fact has been good. On the passenger car a mid to high single digit growth is expected for the full year. The OE still takes it down. Similarly in the truck radial replacement market, we are looking at a double digit growth. The overall demand still comes in at very subdued levels or even negative because in the case of truck radial, a very large proportion of demand comes in from OEM which is negative. The only segment which is still the largest sub segment of the industry is truck bias, there also the demand is in negative mode by about low single digit.

Nishant Vass

ICICI Securities In case of employee expenses on the consolidated basis, there is a significant increase where the standalone is pretty much flat. Is there some one-off in that for this quarter?

Gaurav Kumar It is partially because of exchange rate movement if you compare the exchange rate with last quarter or the last year, Euro has significantly increased and partially because of certain reclassification that is done between R&D expenses and staff cost this quarter which is a one off. So it is a mix of these two factors and there is no real increase in staff cost.

Nishant Vass Though I know you are not talking about Cooper, I just wanted to know in terms of the contract, what is the effective date of the contract?

Gaurav Kumar	The contract is valid till 31 st December.
Nishant Vass	That is not including the working days during the Christmas holiday period?
Gaurav Kumar	I have not read the contract. I was told that it is 31 st December
Nishant Vass	Is there any case where the contract can get re-negotiated?
Gaurav Kumar	Any contract can get re-negotiated if both parties are willing.
Nishant Vas	This is on the same Cooper thing, but more on the management front. Since they announced the deal, obviously the management trust between the American partners and Indian partners were much higher and since it has moved on from that we are into the litigation phase, do you think that if we go ahead with the deal and suppose the deal happens, we will be able to rebuild the trust again to the same degree?
Gaurav Kumar	I would not be able to comment on this right now.
Chirag Shah	
Axis Capital	Can you share some light on what is driving the strong volume growth for Vredestein in Europe?
Gaurav Kumar	The volume growth is essentially a combination of product/ brand equity that they have built up and a series of marketing initiatives. Even in the earlier years we have outperformed the market but not by a quantum that we have seen this year. That's a result of the brand equity and the product performance that's been built over the years.
Chirag Shah	What is your capacity currently in terms of number of tyres and where are you in terms of utilization and what is the scope of increasing the utilization?
Gaurav Kumar	In Europe we are currently at a utilization level of just below 90%. It can be improved by 5 – 7% point because that's the maximum you can operate at. We are at a capacity of about 16,500 tyres a day for passenger car and under an expansion program that we had initiated some time back, capacity will go

up to about 17,500 tyres a day before the end of this financial year. Further expansion that was planned has been put on hold given the market situation.

Chirag Shah Is it right that the raw material cost benefit is also reflected completely in the South African and European businesses or it is a lag of one quarter?

Gaurav Kumar It is usually with a lag of one quarter but given that the raw material prices have been down now over a number of quarters, to that extent it is fully factored in.

Chirag Shah Could this be the reason for severe price cuts that have happened in the European markets?

Gaurav Kumar Some of that benefit has had to be passed on to the customers by the industry.

Chirag Shah Is it fair to make an assumption that the price cut scenario in European market is behind us? Also wanted to understand the severity of 7% drop in your realizations, I believe industry would also have witnessed similar drop?

Gaurav Kumar Industry would also have witnessed a similar drop. We have not got the volumes on back of higher price reductions than competition and as I mentioned earlier the market grew by 4% for the first time in September-2013 quarter after a number of quarters of negative growth. So to that extent as of now there is no indication that there should be further price cut actions taken by the industry.

Chirag Shah Incase of Cooper transaction, is there a scope of taking the matter to higher court by any of the party?

Gaurav Kumar Yes, the decision can be appealed in the Delaware Supreme Court and that's the only level of appeal.

Jasdeep Walia

Kotak Securities Just wanted to get the volume number for standalone business in terms of growth on a YoY basis?

Gaurav Kumar	The volumes declined by 7% in this quarter on YoY basis.
Jasdeep Walia	What is the gross debt number for the consol entity?
Gaurav Kumar	Rs.30.3 billion.
Jasdeep Walia	Does your contract with Cooper give you the right to walk away from the transaction at any time after due diligence has been done and after paying break up fee of \$112 million?
Gaurav Kumar	It doesn't give us the right to walk away after due diligence because after that we signed the contract. If we walk away there is a break up fee involved of \$112.5 million under certain conditions. I would not be able to get into that detail now.
Jasdeep Walia	You mentioned about Rs. 0.7 billion of expense has been booked somewhere, can you explain that?
Gaurav Kumar	Rs. 0.7 billion of expense that has been incurred is relating to financing activities and as per the accounting norms, that doesn't have to be charged immediately to the P&L. It can be amortized over the financing period, so it is not getting reflected as additional expense and impacting the profitability in this quarter
Mahantesh Sabarad	
Fortune Equity	What are the capacity expansion plans in Vredestein? You seem to be stuck in terms of the total volume growth there in Europe, are there plans to augment the capacity by supplying tyres from India?
Gaurav Kumar	There are plans and the volume at Vredestein has been growing. As I mentioned in this quarter it has grown at 15% as compared to an industry growth of just around 4%. There was a capacity expansion planned at Vredestein and we do supplement it from additional supplies from India. Because of the industry situation, in terms of capacity expansion at

Vredestein, we are only going ahead with phase one and would keep an active look out of market conditions before we trigger for the growth in Vredestein.

Mahantesh Sabarad If we see past three to four years trend at Vredestein, there doesn't seem to be any substantial augmentation of capacity there. So what are the plans ahead when we look three years or five years from now, what are the kind of capacities that you are planning there?

Gaurav Kumar Vredestein itself has certain limitations in terms of how much you can grow because of the land available with it and how much you can build on top of that land, so if we look that far ahead, we would need additional capacities for the European market and at one point of time we were looking at Greenfield in Eastern Europe. Subsequently as we talked to some of you, Cooper had operations in Serbia which would have provided us with that capacity.

Mahantesh Sabarad Then I have the second question related to whole Cooper transaction, is there an option for you to give up your Chinese JV, rather Cooper gives up the Chinese partner and gives up the JV altogether?

Gaurav Kumar I would not be able to answer that question.

Aniket Mhatre

Standard Chartered

Securities Can you give us an outlook on the South Africa industry and your operations there as the margins seems to have come down on a sequential basis?

Gaurav Kumar Margin decline is primarily on account of volume decline as the industry went through some bit of sluggishness. Our volumes declined significantly by about 15% which led to margins coming down. However, the benefit of lower raw materials, etc., meant that EBITDA margin was still 5.7% with a positive net profit level. Our focus has been to prepare now for the transaction closing which as I mentioned earlier would be now end of this month.

Aniket Mhatre	The outlook remains to be benign?
Gaurav Kumar	Outlook remains moderate.
Aniket Mhatre	So two months of full South Africa operations and one month of only one plant, would that be fair assessment for Q3?
Gaurav Kumar	That's correct.
Vishal Shroff	
SBI Mutual Fund	You mentioned that the European operations had a volume growth of 15%. The revenue growth looks much higher and you were also talking of price cuts, can you please help us understand what is the volume growth there and how is the realization YoY?
Gaurav Kumar	The higher revenue growth that you are looking is impacted by the exchange rate because of the rupee weakening and negative 7% impact of price and mix
Vishal Shroff	And how is the pricing in local currency there YoY or QoQ?
Gaurav Kumar	Pricing is down 7% YOY, price and mix combination.
Vishal Shroff	How do you expect the trend going ahead?
Gaurav Kumar	As of now, it is difficult for me to say whether we will continue to outperform the industry to this extent but we expect the top line growth to be there even with removing the exchange impact. So Euro-to-Euro also we are looking at a top line growth of close to double digit in spite of the price mix impact in near term.
Vishal Shroff	And this 15% volume primarily would have come through exports from India or local production?
Gaurav Kumar	Primarily local production. The export from India is still a very small proportion.

Vishal Shroff	Can you help us with that number? Earlier we had planned to ramp up exports from India significantly for Europe?
Gaurav Kumar	The exports from India which is primarily Apollo brand, continues to grow, it has grown up by nearly 50% but in terms of overall proportion of Vredestein revenue, it is still just about 10%.
Vishal Shroff	Can you give some sense of how the domestic market is in terms of pricing and margins, we have seen the industry getting to a margin level which is very difficult for industry historically to attain and we have been continuing at this level for some quarters. How do you see that trend going ahead? Do you see industry changing in terms of the way, they look at margins and pricing or it's just a one quarter phenomenon, will they revert to older margin trajectory?
Gaurav Kumar	It is difficult for me to give guidance on margins. But we have been able to maintain margins at these levels. We would continue to strive to maintain margins at these levels which has always been the attempt. Industry situation or actions by other players sometimes dictate that we are forced to react to that which we will have to but, otherwise we would always strive to maintain margins at levels which are around the current levels.
Vishal Shroff	Can you give some indication of any pricing or discounting trend over last 3 – 4 months to help us understand how it is moving?
Gaurav Kumar	There has been discounting off and on, given that the volume scenario or the demand scenario is challenging and you have to react to that. Other than that, we have taken small price increases. For example truck radial replacement, we took a price increase of about 2.5% in August. Similarly in passenger car we took a price increase of about 2% again in the replacement market. There have been no price increases in OEM given the demand scenario.
Ajay Sethia	

Centrum	How is the replacement demand on truck side for the first 6 months and how do you see that going forward? And is there any reduction in premium which we have seen in the PCR side compared to Michelin and Bridgestone?
Gaurav Kumar	The replacement for the truck radial has been growing at double digit whereas the cross ply is negative low single digit. Overall truck replacement number would be flat to slightly positive for the overall industry. Michelin also has taken price increases so that the premium hasn't come down.
Ajay Sethia	Now Michelin is starting their facility in India, is there any indication on ground that premium might come down over a period of time?
Gaurav Kumar	As of now, no indication. We will only have that scenario playing out in the coming years but yes, to that extent they would become a major player in the truck replacement market.
J Radhakrishnan	
IIFL	Can you give some more detail on the one time transaction cost of 30 crores and 100 crores for this quarter? Is it pertaining to some hedging cost or what it is?
Gaurav Kumar	A very large part of that is legal cost, various advisors which were engaged for due diligence, and the financing cost were related to all the kind of fees which was incurred for finalizing the various financing documents with the funding banks.
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	Thanks everyone for attending the call.