"CEAT Earnings Conference Call"

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Moderator Ladies and gentleman, good day and welcome to the CEAT Limited's Q4 FY13 Earning Conference Call. As a reminder for the duration of this conference, all participant 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 call, please signal an operator by pressing * and then 0 on your touch tone telephone. Please note that this conference is being recorded. I would now like to hand over the conference to Mr. Anant Goenka, Managing Director at CEAT Limited. Thank you and over to you sir.

Anant Goenka Thank you. Good afternoon and a very warm welcome to CEATs Quarterly Investor Call. I am Anant Goenka – Managing Director of CEAT and I have with me Manish Dugar – our CFO. Thank you very much for your interest in CEAT. I will give you a brief update on our results and a few key parameters relating to the results after which we both will be happy to take questions. Pertaining to the performance highlight of the year gone by, we registered a revenue growth of 9% driven by a volume growth of 6%, remaining 3% was due to price and mix change. The 6% volume growth was mainly on account of higher growth in the OEM segment as we entered into a number of new OEs such as Volvo Eicher, Bajaj, Hyundai, Royal Enfield etc. Volumes in exports and replacement were close to being flat. The 3% price mix change was primarily because of higher realizations in exports and in the replacement segment which increased our overall realizations. Also raw material prices softened. Compared to last year our raw material prices have come down by about 4 – 5% which led to better margins. So the combined effect of all these factors led to an EBITDA expansion 320 basis points for the full year. In terms of our key product categories we consolidated our position in the 2 wheeler and utility vehicle segment by increasing our market share. Our focused advertising campaigns have been key catalyst to market share growth. Our investments in brand building will continue going forward. We also launched a number of new products. A premium range of SUV radial tyres called CZAR this year and we have a healthy pipeline of 100 plus product launches planned in FY14. And this gives us some positivity in terms of volume growth going ahead. Our plant in Halol has also ramped up and production is at about 80% plus utilization at the close of the year. A few highlights with respect to the quarter 4 performance. Our volumes grew by 11% sequentially with exports and OE registering a volume growth of 17% quarter on quarter. And the replacement segment grew by 6% quarter on quarter. While volume registered growth the net impact due to price mix was around negative 2% on account of some pricing action during the quarter in the replacement and OE segments. NR prices have softened quite well by about 7 – 8% in quarter 4 which has also resulted in margin expansion by about 220 basis points.

A quick update on Sri Lanka. In terms of market position we continue our leadership in the key categories of truck, passenger car and 2 – 3 wheelers. Our overall market share stood at around 50% levels. We have launched new products this year in the PCR and premium truck categories and I believe all of this will further strengthen our position in FY14. Overall its been a very good year for us in Sri Lanka with a healthy top line growth of 4% in a market which was de growing at 384 crores top line and the bottom line growth of close to 50% at 39 crores.

With respect to Bangladesh we shared the details of our joint venture in our last call. And I am happy to share that we have completed the land acquisition for the proposed plant and project execution has begun for the plant in Bangladesh. We expect operations to start in the latter half of FY15. Going ahead we anticipate a muted demand scenario although raw material prices are expected to remain stable which should ensure stable margins. Our investments in operational improvement initiatives will help us in our productivity gain and better efficiencies which could help us improve our margins further. I will now hand over the call to Manish Dugar who will take you through the key financial parameters.

Manish Dugar Thanks Anant. Good afternoon to everybody. This is Manish Dugar here. I will take you through the financials for CEAT India and CEAT Sri Lanka and then the consolidated numbers. On a standalone basis full year revenue for FY13 stood at 4,837 crores up by 9% as mentioned by Anant. EBITDA margins improved by 320 basis point from 5.6% to 8.8%. PBT stood at 145.7 crores after adjusting the exceptional expenses of VRS of 13.7 crores and provision of warranties that we made because of change in accounting policy for about 14 crores as against the PBT of 9.7 crores in FY12. The PBT improvement on a YoY basis was primarily driven by RM cost reduction of about 5% coupled with higher sales realization due to both price as well as improvement in the mix by around 3% resulting in a net gain of about Rs.270 crores. Improved sales volume of 6% across all segments despite the difficult auto segment situation and sluggishness in the replacement market led to a bottom line improvement of about 36 crores. Partly negated by increased higher employee cost of about 53 crores, a large part of it was because of change in the way we account for gratuity and VRS impact on gratuity. Significant investment in brand building which you would have seen in the ads of about 30 crores in terms of increased ads spends over last year. And exceptional expenses as I mentioned before. On a sequential basis, revenue was up by 8.6% driven by 11% growth in volume and price and mix contributing to a negative 2% owing to passing of benefits of reduced RM cost as led in the industry and market. However due to soft RM prices, EBITDA expanded by 220 basis points to 10.7% from 8.5% on a quarter on quarter basis and PBT stood at 78.5 crores as against 25.1 crores in quarter 3 FY13 and Rs.59.9 crores in quarter 4 of FY2012. Key reasons in increase in PBT on a sequential basis are 1) reduction in RM cost by about 6% which was partly off set by reduction in realization of 2%. Impacting a net 29 crores in the bottom line. Improved sales volume of 11% across segments impacting the bottom line positively by 21 crores and reduction in interest cost of Rs.3 crores on a quarter on quarter basis. The other key highlight is reduction in leverage. We started with a 1.9 debt equity ratio at the beginning of the year which we have brought down to 1.33 which effectively meant a reduction in debt by 269 crores from 1280 crores at the beginning of the year to 1012 crores at the end of the year. However the debt reduction took place mainly in the last 2 quarters and the benefit of lower base rate which came out of negotiations and re – adjustment of our debt portfolio happened effectively February 2013. Hence the impact on the interest cost will be felt more on the subsequent quarters in the coming full year. The ROCE moved up from 9.7% in 2012 March to 18.0% as of now and the return on net worth improved from 1.2% last year to a 15% at this point in time. Coming to Sri Lanka JV, net revenues went up despite even more difficult market situation that India by 4% at Rs.384 crores for the full year which was mainly on account of price mix change as volumes were flat. Margins also expanded by 420 basis points to 17%. Sri Lankan JV operations reported a PBT of 53 crores with a PAT of 39 crores compared to a PAT of 27 crores last year. On a consolidated basis net sales for FY13 stood at 5009 crores up 8.6%. PBT stood at 166.5 crores which is after adjusting the VRS expense of 13.7 crores and 14 crores of warranty expenses. As against a total PBT of 24.2 crores in FY12. On a quarterly basis, net sales stood at 1,333 crores up 5.6% YoY and up 7.6% quarter on quarter. PBT stood at 84.3 crores as against 32.6 crores in quarter 3 FY13 and 68.1 crores in quarter 4 FY12. Like a 269 reduction in the debt on a standalone basis including Sri Lanka, the total debt reduction was 273 crores for the full year on a consolidated basis. With this I now invite questions from you. We will be happy to answer them now.

Moderator Thank you very much sir. Ladies and gentlemen, we will now begin with the question and answer session. Our first question is from the line of Basudeb Banerjee of Quant Capital. Please go ahead.

Basudeb Banerjee Few questions, what is the consolidated CAPEX and investment plan for FY14 including Bangladesh project and India business Sri Lanka?

Manish Dugar In the coming year we don't have any additional CAPEX plan other than like you rightly said routine CAPEX and the balance of Bangladesh. The routine CAPEX will be in the range of 60 – 65 crores and Bangladesh project will require a total equity contribution from CEAT India of 57 crores. Out of which about 10 crores will come in the form of technology fees from the JV partner and of the balance 47 crores, 38 crores have already been invested in the year 12 – 13 when we bought the land there. So effectively just about another 9 – 10 crores that we will have to put in into the Bangladesh project from CEAT India. However having said that this is not a reflection of what will happen to our capacity because like you know we have done a decent job in developing outsourcing model and we have discussions happening with our partners who have already started investing in building the capacity for the coming year. So while we will have some capacity expansion in the form of better utilization of our existing capacity and the expansion plans that we have already invested in Halol, Bhandup or Nasik. But a large part of capacity build up will also happen through the outsourcing route. So that's the view on capacity as well as on the CAPEX,

Basudeb Banerjee Because I am asking this question is I broadly see this kind of margin trend continues you can easily have a free cash flow generation of 300 crores plus in FY14 and with 70 – 80 crores of CAPEX needed, so will you be open to the debt repayment of the remaining magnitude or anything else as such?

Manish Dugar Basudeb, we have mentioned earlier also that we would be happier to have a lower debt equity ratio and that has been a constant objective plus we have also shared earlier that we would like to look at as much as possible a strong management of cash flows. We have done a good job on working capital, profitability have supported and a combination of this led to a 273 crores reduction in the debt. Our endeavor will be to use the free cash flow to further reduction in debt and unlike 53 crores of interest that we paid in Q1 of this year, we have brought it down to 45 crores which also bring in sustainability in profits and reduction in risk and we would like to see it come down even further.

Basudeb Banerjee Sir second question is was this consultancy charges which you were paying included in the other expense this quarter also? And how many quarters it will last further?

Manish Dugar Yes it was. It will be one more quarter. So quarter ending June will be the time when it would have fully got paid out. .

Basudeb Banerjee So per quarter how much sir can you repeat?

Manish Dugar About 5 crores.

Basudeb Banerjee And sir last question is with this favorable raw mat prices and margin of most of the domestic tyre players expanding will it be right to assume that there is further scope for price cuts as it was announced couple of months back through the whole industry.

Anant Goenka This is Anant Goenka. Difficult to say that the price cut would happen. In my view it is less likely because this is also the season where generally demand is high, supply of rubber is also low at this point of time. So the possibility of raw material prices going up is there. On the other hand international rubber prices are at all time very low levels at this point of time. So in my view the next 4 – 5 months I expect raw material prices to be little stable or may be a minor increase in raw materials. So I don't see much opportunity in the price cut going forward. It could mean very small level.

Moderator Our next question is from Amin Pirani of Deutsche Bank. Please go ahead.

Amin Pirani I have 2 – 3 questions. First of all on the replacement side you mentioned that it was flat volume growth this year. Could you break it up as to what were the trends you were seeing in the passenger car segment, what were you seeing the truck side or similar?

Anant Goenka We have primarily grown in the non truck segment. We have seen very good growth rates in motor cycle segment. We have seen good growth rates in the last mile which is our Tata Ace type vehicle. So nearly 20% plus growth in motor cycle about 15 – 20% growth in the last mile. T & B radial we have really increased our capacities so actually we have grown by 90% but with a very small base in a way. On the passenger radial side also with Halol coming we have grown at about 10% plus. On the truck LCV side we have been kind of flattish. So that is anyway about 55% of our business. So that's why overall growth has been little bit on the flat side.

Amin Pirani Okay but going into this year are you seeing any trends changing at least on the replacement side?

Anant Goenka On the replacement side I think going forward I think one is quarter 1 should be little bit better because of the seasonality factor but I do believe that there can be little bit improvement on the replacement not too much may be a few basis points improvement in growth nothing else has changed in the economy over the past 3 – 4 months. I don't see much change though.

Ameen Pirani Because I think a normalized rate of growth for replacement would be 4 – 5% a year right or would it be higher? A normalized rate of growth for the replacement segment would be something like 5 – 6% per year or would it be higher?

Anant Goenka In my view it should be somewhere around at least GDP growth rate or little bit more may be 2 – 3% higher than GDP. So when we were growing at about 8 – 9% actually replacement was growing at about 11 – 12% per annum kind of levels. I was saying even now it will be at 6 – 7 % type growth.

Amin Pirani If you don't mind what was the CAPEX in fiscal 13?

Manish Dugar This is Manish here. The total CAPEX that we had in 2013 was the routine CAPEX of around 65 crores and the investment we made in Bangladesh which is about 38 crores.

Amin Pirani So no capacity expansion as such at your end at least in fiscal 13 as well?

Manish Dugar Well the 65 crores did include putting up small expansion within our Halol and Nasik plants. But nothing major.

Amin Pirani And can you just remind us what would be our passenger car radial and truck bus radial capacity, could you share that?

Anant Goenka Capacity of passenger car radial is we have about 70 – 80 tonnes per day. And truck bus radial is about 80 tonnes per day.

Amin Pirani And your overall capacity utilization would be around 75 – 80%.

Anant Goenka So basically in the passenger car segment we have about a 12 tonnes capacity in our Nasik plant which is fully utilized. Now our Halol plant out of 70 tonnes we are currently operating about 50 – 55 tonnes per day not because of sales side but on the production side being a new plant they are still ramping up.

Amin Pirani And you think that you should be quite comfortable with these capacities over the next 1 – 2 years or you think you will have to invest in more capacity say in fiscal 15?

Anant Goenka We have not taken any decision at this point of time. On the truck bus radial side I think we will be pretty comfortable or we are not planning to expand on the passenger segment that could be a further requirement but no plan as of now.

Amin Pirani Just on the truck bus side also your capacity utilization will be in the 70% range or would it?

Anant Goenka No that's about 90% plus. So an 80 tonner per day capacity we are at about 75 tonnes per day.

Moderator Our next question is from Rahul Soni of Baljeet Securities. Please go ahead.

Rahul Soni 2 questions from my side. One is on your interest payment. So after reduction of debt about 270 crores this year what is your expectation on your interest cost for FY14?

Manish Dugar With the reduction in debt 2000 crores levels and current cost of funding our run rate per quarter is 45 crores. And there is this CAPEX and the Bangladesh project payment which is coming up due. The other things which we are looking at is improving our mix of long terms and short term funds currently we have a high skew towards short term funds given that some of our long term project funds have come up for repayment. So we might look at getting some long term funds to improve the balance and that might increase the cost of funding little bit. Also we are trying to do is get the funding for Bangladesh project beyond the equity portion for more right cost perspective. If we take a local currency the cost is coming very high and if we take up foreign currency loan it will be lower. So they have to figure out where we take that fund in. whether we take that in the JV or we take it in CEAT India, depending on those scenarios really we will have to figure out what the interest cost will be. Assuming we only limit our cash outflow to the dividend that we have declared which is Rs.4 in today's board meeting plus the CAPEX of 65 crores and the balance 10 crores that we have to put in Bangladesh we should see a reduction in the run rate interest cost from the current 45 crores which will mean it will be less than 180 crores that would be if we were to just maintain the current levels.

Rahul Soni So less than 180 against around 197 incurred last year?

Manish Dugar That is right.

Rahul Soni And what's your further plan for reduction of debt? And what is the scheduled repayment this year?

Manish Dugar As this came up in the discussions a few questions back, we expect the internal operational performance to generate significant cash flows. We are currently at a 1.33 debt equity and with improved the profitability, it should add to the equity on one side and help us in repayment of some of our debt and we believe that without having to do much in terms of looking at selling of any assets or monetization of any investments we should be able to get into sub 1 levels of debt equity through internal accruals itself. And that is what our endeavor will be in the short run.

Rahul Soni So current debt is around 1000 crores as on March end?

Manish Dugar Yes.

Rahul Soni What's your outlook on demand sir?

Anant Goenka There is no major change overall. In our view OE demand will continue to be low. However on Ceat side we have entered into a number of OEs and are growing our share of business. So we expect OE yet to grow perhaps the fastest among the 3 segments for CEAT. Exports is said to be looking up in Latin America; Africa and South Asia are also decent market at this point of time but I think expert growth will be limited to about somewhere between 5 – 7% kind of growth levels. And on the replacement side, we see a seasonality reason pick up. I think the replacement will be at 5 – 7% growth as well.

Rahul Soni Given the current raw material prices and current realization, is there any further scope of improvement in margins?

Anant Goenka Not really at this point of time. I think at least with respect to taking prices up it looks very unlikely and raw material prices coming down to below Q4 levels it also looks a little unlikely. So I think at least on that perspective its unlikely to change of there is something with respect to operational efficiency or product mix change or something there can be some change out there but I wont say that improvement in margins is beyond this is likely at least in the shorter term.

Rahul Soni So among your various segment I guess you have the highest margin in truck radials?

Anant Goenka Not really. I don't have the exact data here but overall the non truck segment is more profitable than the truck segment.

Rahul Soni Like the motorcycles?

Anant Goenka Overall.

Moderator The next question is from Nishit Jalan of Nomura. Please go ahead.

Nishit Jalan I had one question, in standalone results, tax rate was significantly lower. It was around 22% while we have seen almost 30% plus in the previous few quarters. Just wanted to understand why was that and secondly there was some reduction in interest rates form February. Can you quantify that what could be the incremental benefit that could come because of that in the next few quarters?

Manish Dugar Taking your second question first. The effective interest cost has come down by about 50 basis points from about 9% to 8.5% and we have got the benefit of that for 1 month in the quarter ended March. That should give us benefits on a full year basis in the coming year. So far as the tax rate is concerned there have been some adjustments in the deferred tax assets. See we are currently a Mat company. We have got carry forward losses against which are more than enough to neutralize all the profits that we have and hence we are paying tax on a Mat basis. However, on a PL charge perspective the effective tax rate should be around 33% like you rightly said. The primary reason why it is looking like 22% is because of some adjustments that happened after we re-looked at the treatment that we have done for some of the assets in the last year. So just to give an example we had taken an inventory without the MODVAT value and the tax for the purpose of calculating tax profits while we are allowed to include

MODVAT and the associated tax for claiming depreciation. So adjustments like that translated to a benefit from a tax perspective and had an impact of reducing our effective tax rate. But that's a one time correction but it will not be a recurring thing in the coming quarters.

Rahul Soni So in the coming quarters we should continue to expect 32 – 33% tax rate?

Manish Dugar That is right.

Moderator Our next question is from Srinath Krishnan of Sundaram Mutual Funds. Please go ahead.

Srinath Krishnan We have been speaking about increasing market share in the replacement segment. Does it mean that we will be utilizing some of the raw materials benefits or softening of raw material benefits that we have; hence spending it incrementally into marketing efforts.

Anant Goenka Markets have improvements is primarily in certain categories. So I would not prefer to restrict it to that. So we have gained market share in a number of categories or gained more in areas where they have been stable and we will continue to invest in marketing activities in the passenger segment. So whether it is motor cycle segment or utility vehicle segment it will be primarily in these 2 segments you will continue to put our ad spends. Those are areas where we are more effective in our view. They are areas where the consumer is directly impacted whereas in the case of commercial vehicles we find that ads are not effective as below the line marketing.

Srinath Krishnan In the initial comments you mentioned there is a 30 crores ad spent during this FY13. Is there a strategy or policy to increase during the current year?

Manish Dugar The marketing spend, there was an increase of about 30 crores like FY12 – FY13. FY13 – 14 we will primarily be somewhere around FY13 levels.

Moderator Our next question is from Vishal Saraf of SBI Mutual Funds. Please go ahead.

Vishal Saraf Sir one thing on the numbers I was going through your presentation, this mentions about standalone profit and profit at Sri Lanka. Standalone is 106 crores plus Sri Lanka is 40 crores. So the total should be around 145 – 146 crores. But on the consolidated performance we have mentioned profits to be much lower. Just wanted to understand is there some loss at the consolidated at some other subsidy level levels in consolidated results?

Manish Dugar You are right that standalone financials in India is at 106 crores. And standalone in Sri Lanka is 40. However being a joint venture of 50 – 50 ownership in the consolidated financials we take only the proportional profit of the joint venture which is why we take 20 crores of Sri Lanka and 106 crores of India which takes it to 126 crores.

Vishal Saraf Still the number here is 120 crores in the presentation. So where is the balance 6 crores going?

Manish Dugar No I was giving you a broad number based on what you just said. But if you look at reported financial Schedule-6 you will see the standalone as well as the consolidated where it ties up exactly. The logic is exactly what I said 50% of Sri Lanka plus 100% of India.

Vishal Saraf Just coming back to Sri Lanka operations this year we have seen significant margin improvement. This basically on cost reduction is it?

Anant Goenka Largely because of raw material price drop that has happened.

Vishal Saraf So do you think the margin improvement is sustainable or will go back to the old margin levels as the contracts with OEs and replacement markets get re negotiated?

Anant Goenka Sri Lanka there is no OE market. It is only replacement market. In my view these margins are more or less sustainable. Mostly looks like it will be sustainable but it depends on again on raw material price movements. Raw material prices go up abruptly then there will be some impact but broadly it could be close to current levels.

Vishal Saraf Any outlook on the domestic margins. We have see margins bounced back significantly from the lowest we say 1.5 years back. And we are close to the peak margins we have seen historically. Plus you mentioned there is no scope for margin improvement in government here in cost revenue has bottomed out. It is kind of looking up hereon. So you think margin should correct here on and what is the sustainable margin possible domestically?

Anant Goenka It is difficult to say what will happen. It depends on really competitive actions, raw material prices I would say this is a positive period we are going through. Going forward yes, this could continue for a shorter term but in the longer term I think raw material prices are more likely to go up and how much of that price increase we can pass on to sustain that is very difficult to say. So I would say I don’t have an answer on that question. What is sustainable or perhaps at least at a PBT level 2 – 3% PBT or 7 – 8% EBITDA should at least be possible.

Vishal Saraf And sir on more clarification on 10 crores investment in the Bangladesh venture you said by way of technology fees, can you just help us elaborate more on that?

Manish Dugar That is the charge we have on Bangladesh company because we are providing the company with technology. So with truck or with tyre manufacturing technology there is charge on the company that we have.

Vishal Saraf So that is being recognized as other income for us is it?

Manish Dugar No the way it works is there is a total investment to be brought in to the company by JV partners in their ratio of ownership which is 70 – 30 and the JV which is created is supposed to pay to CEAT India a technology charge. Effectively what CEAT India has to bring in into the joint venture will be lower by the amount of technology fees that will come in. It is more to do with how much money CEAT India will put in and how much JV partners will put in than recognizing that as a profit or a loss in the bottom line in CEAT India’s financials.

Vishal Saraf So let's say hypothetically you are suppose to pay 70 crores you will actually pay a cash of 60 crores and 10 crores by way of this technology fees. So 10 crores you will recognize somewhere in your books. That's the additional amounts invested. So that will come as income for you. So I just wanted to understand in this quarter, this 5 crores has been recognized as income for us?

Manish Dugar Till this point in time we have just signed a JV agreement and the money is yet to come in. the only activity that will happen from CEAT India that will happen to relation to CEAT Bangladesh is on one side the purchase of land and on the other side some spends that have happened in building up the marketing activity in Bangladesh.

Vishal Saraf Which should have all got capitalized?

Manish Dugar Yes. We are yet to do that because the JV formation has not happened and as per the joint venture agreement the initial funding is to be done by CEAT India. So we have only kept the purchase of land in the capital work in progress. Any spent that has happened in Bangladesh has gone in our normal expense because we were selling Bangladesh as exports earlier also. And nothing in the form of money has come in from the JV partner or the joint venture to CEAT India including for technology transfer fees till this point in time.

Vishal Saraf This 5 crores you have mentioning which would be last tranche in June possibly 5 crores you will recognize in June as other income or some income?

Manish Dugar As and when we will have to look at repatriation norms in Bangladesh and are we able to bring it into India and stuff like that. Till that point in time we have not concluded on how we can do the accounting for this but yes, if and when it comes it will come as a income from the joint venture in to the parent company.

Moderator Our next question is from Jasdeep Walia of Kotak Institutional equities. Please go ahead.

Jasdeep Walia As I understand the industry has taken price cuts in the car radial and truck bias replacement markets in the month of March, am I right?

Anant Goenka Some amount, that's right.

Jasdeep Walia So in next quarter we will have lower realizations this quarter which is 4Q and RM prices will be almost flat. So I am guessing margins from here on should trend little bit lower in the next quarter?

Anant Goenka Yes you are right. There can be a little bit of a drop there.

Moderator Our next question is from Nishant Vass of ICICI Securities. Please go ahead.

Nishant Vass First wanted couple of data points. What was your average rubber and NTCF cost for the quarter and the year?

Anant Goenka We won't be able to share with you exact cost of rubber. But we can give you a broad estimate that rubber prices have come down by 5 – 6% on a quarter-to-quarter basis from quarter 3 to quarter 4.

Jasdeep Walia This is your SAP cost?

Anant Goenka Approximate raw material cost that's right. I am talking about total raw material cost.

Jasdeep Walia Coming back to an earlier question you had elucidated your utilization levels in the TBR segment is close to 90%

Anant Goenka As on exit means in the last couple of months.

Jasdeep Walia We also got a comment that we are not looking for further expansions in the truck bus radial segment.

Anant Goenka Yes.

Jasdeep Walia So if we I get it correctly the last 2 years have been more or less flat to definitely negative in this space in the OE space. So you are not looking at any expansion in volumes in next 2 years per se?

Anant Goenka In the truck bus radial segment we are not planning to expand any capacity in the next year and year and a half.

Jasdeep Walia I am coming from the industry demand perspective.

Anant Goenka The industry demand we will certainly go up.

Jasdeep Walia So you are not interested in capturing that demand?

Anant Goenka Yes that's right. We are going to be putting our resources in other areas like Bangladesh or some amount of expansion is happening in Sri Lanka or other categories.

Jasdeep Walia Any specific reasons to the same?

Anant Goenka We have taken a strategic call to focus more on the non-truck segment and so that's the main reason. We can't look at growing and becoming leaders in all segments. From that perspective we said yes we want to focus on certain segments. In business you have to make trade off. So we have taken a call that commercial segment is something where we would not be investing in a big way going forward at least for now.

Jasdeep Walia With the end of this financial year you would have again revised your discussion with the OEs, what is the kind of margin increase of cost or the contract renewals that have happened. What are the kind of targets we are setting up for the next year?

Anant Goenka I don't have the details of that. I don't think there are any specific changes that have recently happened. If at all there would be a percentage here and there change but I am not aware of any major changes yet, OE pricing or anything.

Jasdeep Walia Because the raw material prices started to fall through the year between FY13. So I was expecting in FY14 we would have come up with some changes in the annual contracts?

Anant Goenka No we don't have any annual contract. It is nearly ad hoc. A few are tied to raw material prices. So that change if it had to happen has already happened and is based on a formula. The other is it happens really on ad hoc basis. So if the OEM comes in and says that okay we want a price reduction or we go in and say we want a price increase or raw material price change we have a negotiation at this point of time and come to us with an agreement.

Jasdeep Walia So in the last 2 quarters have we seen similar demands from the OEs?

Manish Dugar We have a large number of OEs. So among some of them yes we had to drop prices, change or prices in categories but it's a continuous process that keeps happening. Its not something that changed or increased or reduced over the last quarter or so.

Jasdeep Walia I am just trying to gauge what could have been the price differences for mid-year, last year to what they were now.

Moderator Our next question is from Jay Kale of IDFC. Please go ahead.

Jay Kale Actually just wanted to know on your radial truck bias segment and your cross ply segment how much of your capacity is currently produced as cross ply tyres?

Manish Dugar About 80 - 85% of our total capacity is cross ply.

Jay Kale And in the replacement market how has been the acceptance of the radial tyres, are customers shifting to radial tyres or they are still apprehensive about the initial high cost of radial tyres?

Manish Dugar The customers are shifting. There is shift of about 4 – 5% towards truck radial every year. About 3 years or 2 years ago I would say radicalization was at about 12 – 13%. In my view it is about 21 - 22% today. So there is clearly a shift and preference people are realizing the advantages and that will further increase and OE begin to increase their use of radials which they are doing in a big way as well.

Jay Kale What would be our realization difference between replacement truck, TBR, and OEM TBR?

Manish Dugar The OEM pricing would certainly be lower than the replacements pricing. Very difficult to say a percentage because to depend customer-to-customer, etc., but OEM pricing would be lower than replacement.

Jay Kale If I am not wrong about couple of quarters back there was a statement that OEM TBRs are not really making any kind of margins or may be sometimes at a loss of something. Is that prevalent currently with the reduced raw material prices?

Manish Dugar Prices generally with OEM are very low. It can be breakeven in number of categories and not only TBR. So I would say TBR also would be very close to nil margins kind of levels even with reduced raw material it will be very close to anywhere between (-2) to (+2) level.

Jay Kale In TBR? So is this one of the reason for you to consciously not really focus on TBRs and more towards passenger cars and motor cycles where you have higher margins for OEM may be?

Manish Dugar Not really because of that because these margins can change at any point of time. Tomorrow if there is a shortage in TBR or if there is a change in dynamic where customers really realizing the benefits and demand goes up then your profitability can also go up. It's a call that we took that we believe that the passenger segment is going to grow faster. If you look at the developed market the passenger segment comprises of 60% of the market whereas in the developing world it is about 15 – 20% of the total tyre market is passenger and as the country gets richer and wealthier the passenger segment will grow faster. So India change will happen over a period of many years and that's where we want to focus on. Secondly it's an area where we believe you can value add more. So, whether you can differentiate your brand more, you can clearly show and advantage to a consumer you can appeal to him emotional benefit, its closer to an FMCG kind of a product where as the commercial segment the customer really looks a lot at cost per kilometer and the pricing differentials between leaders and number 3 – 4 players are very low. Here you can clearly differentiate pricing and show value by appealing as a brand.

Jay Kale Regarding your TBR margins are definitely low but your passenger cars and motor cycles OEM margins will be as low as 2 – 3%. They would be little higher.

Anant Goenka It very much varies. It actually it could be very different. It could vary from 0 - 10% category levels. I don't want to grow into each category out here but it would vary. I won't want to give specific numbers here.

Jay Kale And your market share in motor cycles?

Anant Goenka I said about 19%.

Jay Kale What was the trend like? It has gone up?

Anant Goenka It has gone up by 5% in the last one year.

Moderator Our next question is from Ashutosh Tiwari of Equirus Securities. Please go ahead.

Ashutosh Tiwari Sir the OEM segment basically whatever raw material rate cut has happened over last 3 months has it been passed on in Q4 only or will there be a pass on in this quarter?

Anant Goenka There was a small price reduction that has happened in the few cases in quarter 4 but overall I can't say really what will happen in quarter 1. It's very difficult to say what will happen in quarter 1. Discussions are on with various people. Some people we are not in discussion. So it's very difficult to say what would happen really in quarter 1.

Ashutosh Tiwari In the export market have we taken any prices cut?

Anant Goenka Export market profitability has gone up mainly because international rubber has come down in a big way. So with international rubber coming down what you can do is you can import that rubber duty free and therefore you have that raw material advantage. There has been some passing on pricing in the export segment as well.

Ashutosh Tiwari Currently how much you source in domestic and how much from outside?

Anant Goenka At least to the extent we export we import that much rubber which is 23 – 24% at least. Rest of it, it depends on the international and domestic price differentials. That varies again month-to-month.

Moderator Our next question is from Ameen Pirani of Deutsche Bank. Please go ahead.

Ameen Pirani What I just want to understand was going forward over the next 12 months how should we look at your margins. As in a sense would it be driven more by the movement in rubber prices or can it be impacted by a shift in your sales mix. So what would be the more important driver of your profitability over the next months?

Anant Goenka Raw material certainly plays a very large role. But I would say that is going to be a bigger changer in margins. The sales mix is something which changes more gradually over the period of time whereas raw material can change very abruptly in a very short period of time. I would certainly say you have to keep an eye on raw material pricing and the pricing passing on or the gains either ways there is always a lag. So that gain or loss is higher in my view.

Manish Dugar Just to add to that I think beyond the rubber prices and operational efficiencies given the reduction in debt that has already happened and for the reduction visibility that we have that brings in a sustainable improvement in profitability if you just look at Q1 of this year to Q4 that has added 32 crores for the bottom line. Some bit of current levels of margins are sustainable independent of raw material price movement and some bit of will be dependant on that.

Ashutosh Tiwari Just to come back on the replacement OEM thing would it be fair to say that as far as trucks are concerned there is not much of a difference in the replacement OEM because you can't price them very differently unlike in two wheelers and passenger vehicles where the replacement tyres can be priced at a reasonable premium to the OEs or is that not correct?

Anant Goenka In the truck segment we have price differentials between replacement and OE. Perhaps I don't know if you are pertaining to the previous question that was asked what I am trying to say is that difference between competitors and pricing would not be much in the commercial segment. So most popular brand versus the least popular brand the price differential would be may be 3 – 4% of maximum 5% in the commercial segment. Whereas as in the passenger segment or the motor cycle segment etc the differential can be as high as 15% or so. Because the brand commands a premium people like you and me would go in and say yes we want this specific brand. We change our tyre once in 3 years' time so I would prefer this brand than the other brands. Whereas for a truck owner he really would look at it is a very big cost for him post fuel tyre is the next most expensive or highest cost for him. He would be very particular on the cost per kilometer or the ROI that he gets from the tyre.

Ashutosh Tiwari And in the case of trucks the replacement cycle would be more like a year, year and a half compared to passenger of around 3 years.

Anant Goenka Passenger would be 2 to 3 years' time. Trucks would be shorter period of time I think 4 – 6 months time.

Moderator Our next question is from Ashwin Shetty from Ambit Capital. Please go ahead.

Ashwin Shetty Couple of questions. One is what is the blended level of price cut that you have taken in the replacement segment and secondly would there by a negative impact of increase in import duty on rubber?

Anant Goenka So we have taken a price cut of about 2%. And with respect to import duty the duty has not yet been passed by the Finance Minister. So it has been proposed so just to give others also an update, there is proposal by Commerce Ministry to increase import duty of rubber from Rs.20 or 20% whichever is lower to Rs.34 or 20% whichever is lower. So at least the absolute part they want to take up by Rs.14. If that happens then there is a likelihood that domestic natural rubber prices will immediately react and go up. Now the question is whether it will happen or not? This was put up about 2 months ago. They are very conflicting views that we hear. We hear news article that it will happen soon. We hear that somewhere it has lost its fizz. And it is not going to happen, very difficult to say and this was proposed at a time where international prices were higher than domestic prices. Right now international prices are about Rs.35 per kg lower than domestic prices. So difficult to say what will happen. If it does happen raw material could shoot up immediately at that point. Rubber price will shoot up immediately at that point time.

Moderator Our next question is from Sriram R from HT Media. Please go ahead.

Sriram R Can you give more details of sales mix in the current quarter at consolidated level when we compare it with Q4 in 2011 – 12? Just want to check your sales mix in the sense that at a consolidated level, can you give what's the volume growth in the quarter when we compare it in the 4th quarter of the previous fiscal year?

Anant Goenka If you look at quarter on quarter growth we have grown by about 6%. Year-on-year about 9% for the whole year to FY13 over FY12 and quarter 4 is about 6% growth.

Sriram R What I am looking at is the sales mix, how much volumes have contributed and what's the price variation in that?

Anant Goenka In terms of volume is about 2% lower and about the balance 2% is because of pricing and product mix change.

Sriram R And another thing what the realization like in Q4 over Q4 like what's the trend you have seen?

Anant Goenka Realization has gone down realization has gone down by about 3% or so.

Sriram R Lastly this is due to the change in prices in the industry like year-on-year changes we have seen?

Anant Goenka That's right.

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

Anant Goenka Thank you very much for coming over for our call and time and we look forward to a lot more further interactions. Thank you.

Moderator Thank you very much. Ladies and gentleman, on behalf of CEAT Limited, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.