



“Apar Industries Limited Q1 FY14 Earnings Conference Call”

August 12, 2013



**MODERATORS: MR. KUSHAL DESAI – MANAGING DIRECTOR, APAR
INDUSTRIES**

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MODERATOR: MR. ALOK SOMWANSHI – ANALYST, FOUR-S SERVICES



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Moderator

Ladies and gentlemen good day and welcome to the Apar Industries Limited Conference Call hosted by Four-S Services. As a reminder for the duration of the conference all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference call you may signal for an operator by pressing "*" and then "0" on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Alok Somwanshi of Four-S Services. Thank you and over to you, sir.

Alok Somwanshi

Thank you. Good morning everyone. On behalf of Four-S Services I welcome all the participants to Apar Industries Q1 FY14 Results Conference Call. Today on the call we have Mr. Kushal Desai – Managing Director, Apar Industries and Mr. VC Diwadkar – CFO, Apar Industries. I would like to thank the management for giving us an opportunity to host this conference call. I would now hand over the call to Mr. Desai. Over to you, sir.

Kushal Desai

Thank you. Good morning everyone and a warm welcome to our Q1 FY14 Earnings Call. I will begin by sharing some key highlights and achievements in the period followed by a brief financial review and post that we can have question and answer session.

We are pleased to share with you several developments that have taken place in our conductor, transformer oil and cable business in the last quarter. We have started a new green field conductor plant at Silvassa with state of the art technology. The plant has an installed capacity of about 36,000 MT. Our production at our Nalagarh facility in the north is being reduced to increase the capacity here in Silvassa. This has specifically been developed keeping in mind a higher level of export which is possible to hedge for some of the slowdown that is taking place in the domestic market. Silvassa is relatively good strategic location as it is close to the various ports around Mumbai. With this our total conductor capacity goes to a 140,000 MT excluding the Nalagarh facility. And with this we have been consolidating our position both in the domestic as well as in the export markets and it also give us added flexibility in terms of servicing both the domestic side as well as the export side of the business.

We have also started the new green field cable plant at Khatalwad in Gujarat. Khatalwad is about a little under 200 kms from Mumbai. The plant houses the two EB Accelerators and it also has a manufacturing for elastomeric cables as well as optical fiber cables. The production of the EB machines has already started. The elastomeric cable capacity has also been commissioned and the optical fiber cable manufacturing capacity will be ready by the end of Q2. With this our overall cable capacity for fiber optics will grow to approximately 100 crores a year which is a little over 100% increase in capacity. This is quite pertinent keeping the fact that BBNL which is Broadband Bharat Nigam Limited is going to go through with a massive optical fiber rollout and the contracts will probably get finalized and issued in early Q3 of this



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year. In this quarter our 1.5 MEB Accelerator also received approval from ERB and has been successfully commissioned.

Now let me take you through each of the individual segment-wise business performance.

In our conductor business we have managed to improve our profitability relative to the first quarter of the previous year even though there has been overall sluggishness in demand. The EBIDTA jumped from 6.4% in Q1 FY13 to about 11.8% in this quarter. This was achieved through a better product mix, tighter cost control and some superior raw material sourcing.

In this quarter like the rest of the market we also faced sluggish demand from Power Grid along with lower capacity utilization due to our plant being shifted from some of the capacity being shifted from Nalagarh to Silvassa. We got all the final operating approvals only at the end of May so there was only one full month of production from the new facility in Silvassa that got captured in the first quarter.

Our conductor business posted net revenues of 341 crores and an EBIDTA of about 42 crores. The current order book stands at 1,117 crores. However there is a fairly healthy pipeline which we are seeing and several orders are likely to get finalized in Q2 specifically with respect to more export orders.

In our transformer oil and specialty oil business our volumes grew by 2% compared to the first quarter of FY13. The division posted revenue of 506 crores and an EBIDTA of 45 crores compared to 42 crores in the first quarter of last year. Better product mix and export orders helped improve our segment margins to about 8.6% from 7.8% in the same period previous quarter. We expect some more tenders to be coming in from the State Electricity Board not only for replacement of transformer oil but also for fresh purchase of transformers and this momentum should hopefully be picking up given that this segment was extremely quite over the second half of last year and as a result we see some upward movement in demand and probably a healthier offtake across various segments in the next three quarters to come.

If you look at the power and telecom cable segment we have continued to achieve some level of revenue growth. Our cable segment grew by 4% from 94 crores in Q1 FY13 to 98 crores in Q1 FY14. We expect the growth rate to actually pick up through the remaining portion of the year.

Our order book also has grown to 164 crores which is 2.5 times the order book in the same quarter last year that we had. We expect to complete our elastomeric cable and fiber optic expansion and the second EB machine has also been commissioned and should start commercial production some time in this quarter. We have also progressed in the approval process for our EB in cables with the Indian railways Defense etc with an aim to complete



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these sometime before December 2013 which would allow us then in the next financial year to start participating in most of the tenders which come out and we are able to address the market in a more complete fashion.

In our automotive lubricant business we have significantly improved our profitability with the help of various measures that include and improve product mix and a higher sale of small packed branded products as opposed to bulk packs which are in drums and we have consolidated our position as one of the largest sellers of lubricant into the three wheeler segment. We have increased our presence in the OEM market where we have today 9 OEMs of various sizes that we have signed and in the past quarter we have added couple more OEMs and this has helped grow our OEM sales volume. We foresee better volumes for auto lubes in the next three quarters based on this expansion of OEMs and the distribution channel. Also the rural demand has picked up due to better monsoons which have been witnessed across most of the country.

Looking at our overall quarterly performance we clocked standalone revenue of 945 crores with a profit after tax of 4 crores. We have expanded our EBITDA earnings before finance depreciation, amortization by 178 basis points to about 76 crores. On a consolidated basis we achieved revenues of 965 crores with a profit after tax of 15 crores. We have expanded our PBT margins by about 43 basis points to post a PBT of 21 crores. There has been a sharp depreciation of the rupee that was witnessed at the end of the quarter, basically in the last 15 days resulting in a higher FX cost and foreign exchange mark-to-market losses. We have already initiated price increases for all our oil products across the board and have been largely successful in the months of July and August in actually passing on those increases. What has helped is that the various price variation clauses are also taking foreign exchange into as an important component of the formula and so automatically those price variation clauses has also got adjusted upwards. So despite this overall difficult environment we are reasonably positive to achieve a decent performance in the rest of the year on account of various initiatives that have been taken up. We expect a stronger demand from Power Grid for the ultra high voltage transformers as focused in power grid moves away from the transmission line side more into the substation where these transformers would go. We would continue to improve our profitability with a better product mix and as I said recently we have corrected some of our prices upwards for the depreciation of the rupee. We also envisage an improved demand for our new generation high temperature conductors particularly in the second half of the year based on various tenders which have already been floated and are in various stages of finalization.

On the cable side we hope to drive significant volume growth in the second half of the year both in elastomeric cables where we have received several orders but their execution really starts from September of this year onwards. And we expect a good inflow of fiber optic cable



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orders both in the domestic market as well as for the export markets. With that the profitability of the cable sub segment will substantially improve in the second half of the year.

With these broad comments I would like to thank you once again for joining us on this call and we would be happy to take any questions that you may have now.

Moderator

Thank you very much sir. Participants we will begin the question and answer session. We have the first question from the line of Maulik Patel from Equirus Securities. Please go ahead.

Maulik Patel

On the conductor business you already have been witnessing the order book declining and in the last two quarters it has stabilized at around Rs. 1,100 – Rs. 1,200 crores so that incremental order flow is coming through more about export in the private where the PGCL is more silent in the last one- two quarters. So, where is the incremental order flow coming from?

Kushal Desai

Let me answer your question in this way. Power Grid at the moment is sitting on a very high stock level of conductors. It is estimated at almost 500,000 MT equivalents to about 7,000 crores worth of conductors. So there is already a substantial slowdown in the ordering fresh conductors for the transmission line sites. The emphasis at the moment is to complete a lot of substation related work. The incremental order flow is coming from EPC contractors in the export market as well as EPC contractors in the domestic market. There has been some amount of increase that has happened from the various state transmission companies who are also executing what I would call as prefunded projects either funding from the power grid or from a multinational agency so that segment is also picking up. Most of these orders are through EPC contractors because these are all EPC contract basis. So what we expect is you will see a smaller order book number in absolute value but the flow orders will be less lumpy. In the case of power grid we used to get a large order flow coming in a fairly lumpy fashion and then be a quite period for a few months and the order book may go to 1,500 – 2,000 crores as you see in the last couple of years and then a period where there is less inflow of orders coming in. The nature of the current set of orders is that there will be a much steadier flow orders coming in and at a given time EPC contractors generally prefer not to place an order which is for the entire line in one shot because the pricing also varies based on various price variation clauses. So I would not be overly worried with lower order book as long as the order flow continues to come in which is something where we are keeping a track of very closely.

Maulik Patel

But in terms of because let's say compared to FY13 and FY14 this year there will be definitely a lot of pressure on volume and then the top-line.

Kushal Desai

Yes we expect a lower total volume to be sold compared to the previous year on the conductor side.

Maulik Patel

Last year we did about 1, 40,000 MT.



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Kushal Desai

Yeah almost 1,40,000 this year will be closer to about 1,10,000 and 1,15,000 but the mix of orders will be a little bit better towards alloy conductors, some quantity of high temperature conductors. Also one significant shift that we made is that we have moved a lot of production from Nalagarh out into Silvassa as I mentioned earlier because of two reasons. One is Silvassa is a lower cost production base relative to Nalagarh. Secondly our flexibility of executing projects has increased because now we can be agnostic to whether it is domestic or export. Otherwise what was happening is that if we had a good domestic order book and export orders came in then we were not able to execute out of our Silvassa plant and the Nalagarh facility was not ideally located geographically for any form of export. So this actually helps improve the position that we have to be flexible between servicing domestic orders or export orders. So that I think is a significant change which should help at least on the cost basis.

Maulik Patel

But given that there is a change in mix in order towards more profitable orders, export and you mentioned about alloys so your margin per metric tonnes should be higher or lower than the last year.

Kushal Desai

No in our conductor business our margin per metric tonne will be lower than in the last year. Last year was the best year that we had but on an overall basis you will see an improvement in the margins on the other two businesses relative to the previous year. That's what at least our analysis is as we look at the situation today.

Maulik Patel

So basically at least till the time PGCL is not issuing an order book we see this Rs. 1,100 – Rs. 1,200 crores type of on an order book.

Kushal Desai

Correct.

Maulik Patel

And on the other business transformer and specialty oil I think rupee depreciation is clearly taking us some toll on profitability and on the overall top-line but we see that we will maintain the last year profitability or at an operating level or there can be a dip in that.

Kushal Desai

No in our specialty oil business we are targeting to have a operating profitability which is higher than it was in the previous year and the two primary reasons for that are domestic transformer oil business we see a slightly better environment than in the previous year particularly as I said with a lot of concentration taking place with supplies to the Power Grid sub-station of 765 KV. So that would have some positive impact.

Secondly we have taken a number of measures in our automotive business to not only grow volumes but to improve the distribution and the product mix in the business so those results have started showing up. In the first quarter it has got little bit round because of the increase in the FOREX hedging cost and the FOREX losses but you will see that emerging over the next three quarters. On the FOREX side if you see if you take that total 58 crores which is 59 crores



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approximately 24 crores is the cost of hedging that has taken place which is either because we have had important raw materials on our conductor side and sold it in Indian rupees so we have hedged so that the operating margins remain intact. For the hedges that we have taken in our oil business and 35 crores are the MTM. One-third of that is clearly because of product which will get exported out so that much portion will get reversed. 20 crores is something which has been incurred or has to be recovered through higher product pricing for which we have increased prices in July and further consolidated some price increase in the month of August.

Maulik Patel

I was even going through your annual report and then there is a significant increase in the export revenue which somehow works as a natural hedge against our import dependability that was there in. This year the export revenue should increase compared to the last year.

Kushal Desai

Our target is to increase our export revenue compared to the previous year and that is being driven by two things primarily because the number of export markets we are covering and the number of customers that we are covering has increased.

Secondly as the domestic market gets a bit quite particularly from the Power Grid side the other opportunity really available in some of the large overseas EPC contracts on the conductor side.

On the oil side we are seeing the target is to have an organic growth takes place and you will see again a substantial jump on the cable side because some of the contracts which were expected in FY13 are likely to fructify in FY14. So even in the first quarter we have exported almost 37 crores worth of cables versus about 10 crores which we had in the same period previous year. So the export side will definitely pick up to cover the sluggishness on the domestic side.

Maulik Patel

And the last one on that EBM project side so we have completed both the machines that we have commissioned it, right and the revenue flow should come probably at one or two quarter down the line.

Kushal Desai

In the second half of this year the revenue flow will start coming in because we are already executing some of the initial orders which we have. Our EBM cable order book is in the vicinity of about 50 crores which will be manufactured in the second half of the year based on its current deliveries schedule but as I said some of the other large buyers, the largest buyer of electron beam cables in India are the Indian railways followed by the Indian Navy so those approvals are still at various stages of coming through which is quite a long drawn out process. So our target is to complete the basic approval process before December of 2013 so we can start participating in tenders from these outfits for EBM cables from 2014 onwards. The first year we will be considered as a part two category supplier for the railways. In the Defence the entire market is open to us so part two means that you cannot get orders beyond 15% of the



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total orders which are offered and that period is for a one year period post which you can then if you successfully complete it that you can become a part one supplier which allows you to do that bid on the entire business. So you will see every year progressively some more business coming from the EBM but the real opening of the market will be a FY15 affair where you can actually we should be able to bid on every job that's being offered in India.

Maulik Patel

And the last question because recently the stock price has corrected a lot and I am sure that Board has probably deliberated or discussed this. Is there any measure the Board is thinking about to increase the investor's confidence into the company?

Kushal Desai

We cannot comment on how the stock market behaves and the prices going down but one thing from the promoter's standpoint is that the promoter's would obviously have confidence in the business and would look at consolidating their own positions in the promoter's holding in the company at this stage.

Moderator

We have our next question from the line of Mr. Madan Gopal from Sundaram Mutual Fund. Please go ahead.

Madan Gopal

Sir this is on the FOREX loss that you are talking about the oil business. The hedging cost of around 24 crores that you mentioned this is a sort of recurring cost from if we have to continuously, this is hedging for the year or if you can explain a bit on this?

VC Diwadkar

This is the hedging for the quarter actually.

Madan Gopal

So this cost is going to be repeating every quarter?

Kushal Desai

The nature of the cost will be rare. There are two parts of the hedging. One portion is coming from the oil business which is something that will recur every quarter simply because we buy in dollars and sell 70% of our output in rupees and re-export about 30% of the value.

On the conductor side it depends basically on the nature of the contract and there we take no speculative position so if you are buying your raw material in dollars against a rupee contract moment the contract is finalized and the pricing is finalized we take immediately a currency hedge so that the entire contracts operating margins are then converted into Indian rupee so that portion is not necessarily recurring. It will go contract to contract.

Madan Gopal

How much it would be?

VC Diwadkar

In this quarter it was close to around 8 to 9 crores.

Madan Gopal

Okay so the remaining 16 crores is the cost on the oil business which will be a kind of recurring.



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- Kushal Desai** Cable business was couple of crores. Also for the same reasons as conductor business where you buy dollar based raw material against rupee based contract so there also immediately take the hedge so that the margins get converted into a rupee based margin. The oil business is incurring about 12 to 14 crores of hedging cost a quarter.
- Madan Gopal** And sir on the remaining 24 crores of MTM losses that you mentioned about
- Kushal Desai** Mr. Madan Gopal it is 35 crores.
- Madan Gopal** 35 crores of which one-third is for probably exports so
- Kushal Desai** Yeah everything else we exported back
- Madan Gopal** So the remaining amount that I am talking about around 20 – 24 crores something like that so this amount you said price increase has happened and you would probably recover a portion of it so should this become half or what depending upon your hedge from the next quarter.
- Kushal Desai** We will be able to recover at least 50% of this portion because as I said we have corrected prices partially in July and then further consolidated the price increase in August.
- Madan Gopal** So this is at what price we have hedged right now?
- Kushal Desai** On our oil business every week we take hedging.
- VC Diwadkar** Every week hedging takes place so whatever the spot rate is there, whatever we are able to get the best rate actually that will be the spot price.
- Kushal Desai** Our imports are covered for our oil business for the months of August, September and October as of the end of July.
- Madan Gopal** Sir last year in the annual report we saw this almost close to 127 crores of this FOREX loss we reported during the year and in the cash flow statement if I look at only 10 crores has been readjusted so is it suggesting that the remaining 117 crores is in cash loss for the year so that's how I have to see so this year also whatever we are reporting except for some MTM loss recoverable through exports remaining I should take as cash loss.
- VC Diwadkar** I have not followed your question Madan truly speaking. Basically in the cash flow statement whatever is MTM loss that will not appear in cash flow statement and last year's MTM loss will come as this year's loss and this year the MTM loss will not appear in the cash flow statement. Other than that there is no adjustment actually even if there is an adjustment in the book.



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- Madan Gopal** No what I was looking at is if there is noncash you are starting the cash flow statement with PBT and this is after the FOREX loss adjustment in the P&L account so if there is a noncash in the cash flow statement you add back that you have done it in FY12 but in FY13 only 10 crores you have added back. So the remaining 110 crores or something so that is probably cash loss that's what I am referring to so that is hedging cost and all this included.
- VC Diwadkar** I will not be able to figure out right now actually. Offline we can take this question.
- Madan Gopal** First on the conductor business looking at the kind of order book it should be tough to even cross a 1,500 – 1,600 crores level for the year in the overall sales.
- Kushal Desai** Our target this year is to do about 110,000 MT so the final value will depend upon, finally the aluminum and steel will actually get priced at through the remaining three quarters. The conductor business will have a lower profitability then the previous year as I had mentioned earlier.
- Madan Gopal** Last time when we spoke you guided for a margin of around 6% so that's the kind of number you still hold on, right, even at the lower.
- VC Diwadkar** On the full year basis.
- Madan Gopal** No on the conductor business.
- VC Diwadkar** Correct on the full year basis.
- Madan Gopal** And on the EBM side depending upon whatever is happening right now will it be possible for us to do more than for 50 crores business is possible to be booked this year or will you see some?
- Kushal Desai** Yes the target is to book about 50 crores in this year because the delivery schedule clearances for manufacture will start sometime towards the second half of September and the delivery is supposed to end sometime in April-May but we have the capacity to actually once we get the clearance to complete this quantity by 31st of March.
- Madan Gopal** On the cable business you highlighted some possible margin improvement. If you can elaborate and kind of say what kind of margins are there?
- Kushal Desai** There are three things which I can more specifically mention.
- One is that the fiber optic business for us in the second half will grow from the current level which we are doing about 4 crores a month will increase little over 8 crores a month. So there will be a 100% growth on the fiber optic side from the second half onwards. This is on the



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back of some domestic large tenders which are likely to get finalized before 30th of September where the tenders are already open and we have our positioning on pricing, etc., is already clear as well as some increased export contracts which we have received.

In addition to that you will have the elastomeric and EBM cable volumes which will be higher than in the previous year on the back of some of this which I mentioned earlier.

And the third thing is that we see an increase in turnover of our cable business should grow almost 20% over the same period previous year so compared to FY13 or FY14 should be approximately 20% higher based on the current order book that we have as the current market outlook. So with that we actually see an improved performance coming in our cable business. Most of this is going to hit in Q3 and Q4 when the orders are likely to be executed.

Madan Gopal Overall adding both these businesses last year we had a kind of breakeven at the segment level, cable business and EBM. This year we should be looking at somewhere like at least 3% - 4% margin.

Kushal Desai We are looking at a positive number at the segment level. Finally depends on how much gets executed prior to 31st March but as I said the second half of the year will have a much stronger performance and lot of these orders are already either booked by us or in the pipeline.

Madan Gopal On the conductor side you said renewed kind of ordering pipeline from ECBs, is it so substantial or how do you put it?

Kushal Desai Well it cannot substitute the entire volume which is coming from Power Grid but that segment has been extremely quite in the past couple of years and now the transmission lines are going on within the state.

Madan Gopal Which states are these which are coming up with orders?

Kushal Desai They are running across several states so you have got Rajasthan, Madhya Pradesh even UP, Maharashtra, most of them are funded projects so they are either through Power Finance Corporation or in some cases there is multilateral aid that has been declared so that partly compensates some of these slowdown which is there from Power Grid. So this is largely come through EPC contractors and plus there is increased activity taking place from some of the private players but together it is not able to offset the slowdown from Power Grid so even if we add up export the transmission lines from the SEBs as well as private players put together the volume is not able to compensate what we see as the reduction on the front of Power Grid that is the reason why my overall sales volume will be lower than in the previous year.

Madan Gopal On the oil side you said 765 kV is picking up. Can you give a rough cut number of how much was 765 kV last year and where it should be this year?



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Kushal Desai

Well I don't have specific numbers available but in general what is happening is that more of the substations are now coming in for implementation and completion. So as a consequence the transformers are being shifted to these substations and oil is the last ingredient that goes into the transformer just before commissioning. So you will see a much higher level of substation commissioning happening in this financial year as a consequence of which we expect some of our oil deliveries to go up. In addition to that the general SEB segment whether it was on the transmission side or the distribution side was extremely slow in FY13 particularly in the second half of FY13. So after a prolonged period of very little to no buying of either transformers or transformer oil both the segments are showing some levels of increased activity. So the OEM sale through transformer manufacturers to SEBs as well as some amount of direct sale to SEBs is both likely to be higher this year than in the previous year.

Madan Gopal

Sir when you are referring to the conductor business you were mentioning that PGCL inventory is almost like 7,000 crores worth is that the number that you referred or I got it wrong?

Kushal Desai

No that's the sort of estimate that we have.

Madan Gopal

That's huge right. That's kind of three times if I put together yours and Sterlite that is almost double the kind of number that you do yearly.

Kushal Desai

It's exactly. It's almost two years worth of inventory that they have. They normally carry I guess 9 to 12 months worth of inventory so there will be significant correction that is the reason why the tender finalizations are going slow and the ordering is going slow from Power Grid. I think lot of attention has moved to completing substation so the activities from Power Grid will be still on if you see that at the macro level but it's less on the transmission line side and more on the substation side.

Madan Gopal

But I am hearing most of the companies in this space in this quarter has been disappointing on the execution front so like the way you are saying the pain is in the conductor and not on the substation. It's across probably?

Kushal Desai

You do need to keep in mind that large transformers commissioning during the pre-monsoon, monsoon period is at its lowest level and post monsoon it really starts picking up because of the climatic requirements. If the moisture levels are high they don't board well for electrical equipments getting commissioned. So this impact is something which is not uncommon and these are ultra high voltage system so you will see a much larger amount of commissioning taking place from now onwards to March. But the indications which we have from directly or indirectly from the Power Grid or the suppliers to Power Grid shows that we will be shipping much more than what we did in the previous year.



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Moderator Thank you. We have our next question from the line of Rishen Goswami from Locus Investments. Please go ahead.

Rishen Goswami What's the CAPEX guidance would be for the year?

Kushal Desai Last year we ended up spending a 110 crores in total CAPEX so that includes whatever was incurred during the year plus WIP and this year we expect it to be in the vicinity of about 70 crores which would completely essentially the major expansions on all the three businesses which is the oil business, the conductor business as well as the optical fiber side.

Rishen Goswami And this includes the maintenance as well, right.

Kushal Desai Yeah this is the total CAPEX. In fact most of the CAPEX for this year is front-ended because it is on the completion of some of the cable projects as well as the conductor project.

Rishen Goswami And what's the total debt on the books now?

VC Diwadkar The long-term debt will be close to around 60 crores.

Rishen Goswami And short-term.

VC Diwadkar Short-term debt is around buyer's credit of 1,000 crores, PCFC is 50 crores and public deposit is 21 crores. Against that margin money are there.

Kushal Desai Margin money is about 880 crores and the free cash is about 90 crores.

Rishen Goswami So the entire buyer's credit that comes under the payables, right.

VC Diwadkar No buyer's credit is disclosed separately actually.

Rishen Goswami Are you sharing the conductor volume number for the quarter?

Kushal Desai No we don't have that.

VC Diwadkar Normally we don't share it actually. At the end of the year we share the conductor volume.

Moderator Thank you. As there are no further questions I would now request Mr. Alok Somwanshi to add closing comments here.

Alok Somwanshi I would like to thank the management for giving us the opportunity to host the call and all the participants to join in the call. Thank you.



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Moderator

Thank you sir. On behalf of Four-S Services that concludes this conference. Thank you for joining us. You may now disconnect your lines. Thank you.