

Conference Call Transcript

Apar Industries

Q2FY11 Results

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Corporate Participants

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CFO

Questions and Answers

Moderator: Ladies and gentlemen, good day and welcome to the Q2FY11 earnings call for Apar industries hosted by Edelweiss Securities Limited. As a reminder 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. If you should need any assistance during this conference call, please signal an operator by pressing * and then 0 on your touchtone telephone. I would now like to hand over the conference to Mr. Rahul Gajare of Edelweiss Securities Limited. Thank you and over to you sir.

Rahul Gajare: Thanks Farah. Good afternoon everybody. I welcome everybody to the conference call of Apar Industries Q2FY11 earnings. We have with us the management Mr. Kushal Desai – Managing Director and Mr. Diwadkar – CFO. We will have opening remarks from Mr. Kushal Desai after which we will move onto the question and answers session. Thank you and over to you sir.

Kushal Desai : Good afternoon everyone and thank you for taking the time to be on this investor update and earnings call. I will quickly go through initially some of the key numbers and highlights and then throw it open for questions. Fundamentally, our second quarter was a good quarter. Turnover for the company as a whole was up on standalone basis by about 37%. The first half turnover is up by about 30%. In terms of EBITDA, we were up by 27.3% in the second quarter. PBT was up by 67.3% due to a sharp reduction in our interest cost and then finally PAT and EPS in the second quarter were up by 52.7%. If we look at it from a first half stand point, EBITDA was up by about 21% and PBT up by 48%, and then PAT and EPS were up by 24% in spite of a much higher tax provision that we have had to make.

I will then jump straight into the segment analysis as such. We will first cover the conductor segment. Sales revenue for that segment was up by about 36% over the corresponding period in the previous year. The volume growth was about 14%. In terms of the first half revenue was up by 18% and the corresponding volume growth was about 12%. The conductor segment has an order book of about INR 1157 crores as of 30th September.

During the quarter, we received orders worth about INR 332 crores which consisted of about INR 117 crores from exports and INR 215 crores from the domestic market. This was in spite of no orders coming through from power grid and if the value is almost equivalent to what we executed in terms of sales during that quarter. So in spite of the situation, the company has its order book inflow and several of these orders have come from some of the new transmission companies that have been executing these build own and operate projects as well as some of the other turnkey operators both domestic as well as overseas. So this also indicates the position that going forward the demand is going to be in a broad based and, therefore, the dependence on business from

Power Grid, especially in the next year, should reduce. The information that we have is totally tenders of about INR 2500 crores have been participated by us with Power Grid. But none of these orders have been firmed up for tenders open since November 2009.

There is a likelihood that these tenders will be finalized December onwards once Power Grid has been able to clear lot of their capital work in progress which sits at almost INR 19,000 crores. So, December onwards we expect some of these INR 2500 crores worth of tenders to be executed. Our historical market share has been in the 20% range, so hopefully, we should be able to add another INR 500 crore to the order book from these tenders. There are another INR 2500-3000 crores worth of tenders which have been lined up by Power Grid for opening between December and April 2011.

What we are fundamentally seeing here is with power project having reached financial closure and the momentum growing for these executions on the power projects, we believe that the tenders for the transmission lines will also really start picking up pace 2011 onwards. In terms of segment level profitability, the percentage is similar to that of the first quarter which is about 4.9%. Several of these orders were taken during 2009 period when neither Power Grid nor some of the BOO projects had reached financial closure and the competition or the competitive environment was much more intense. We expect that as we end the year and get into FY12, margin expansion should take place. And some of this is already reflected in the pending order books that we are carrying. And finally, on the conductor side, one of the areas which we have been concentrating on given that it is a product of the future is high-temperature conductors. These conductors essentially carry more power on the same lines; they can carry between 50 and 100% more power on the same transmission lines. In the last quarter, we executed our first really significant order of high-temperature conductors which was about INR 3.25 crore in terms of value about USD 750 000. And this was a repeat order from an overseas utility which first tried out the proof of concept and has then placed larger order on us. So, this actually is very significant because it gives us a clear customer reference in terms of the success of the high-temperature-conductors which we have manufactured.

Coming to our transformer oil and specialty oil segment, sales revenue in the second quarter grew by about 38%. There was an increase in volume of about 4%. However, there was a big change in mix of product which we executed in this quarter. If you see the growth that we had in transformer oil in the first half relative to the same period previous half it was up by nearly 40%. And some of the lower sales we ended up executing in our white oil business where the margins were lower so we decided to concentrate in more on transformer oil and less on white oil, given that some of the raw materials are fungible at the lower end of the transformer of oil spectrum. In terms of the segment level profit for the second quarter, we ended up having a 77% increase over the corresponding period of previous year and for the half-year period is up by almost 56%. As I mentioned earlier the improved performance can be attributed to fundamentally volume growth that has happened coming from transformer oil

as well as a sharp improvement in the product mix. The second quarter that is, for the first time where we started having some significant shipments of the transformer oil going into 765 KV transformers and Grades meeting the new specifications as have been set by Power Grid and Bhel for EHV transformers. And is an area where Apar stands to differentiate itself from the rest of the players in the segment. And we also had a number of orders on a specialty industrial oil grades which carries better margins. So these were the real contributors towards a much higher profitability that came through. The company also executed for the first time under the new performance specifications 400KV HVDC or high-voltage DC transformers for Power Grid. And these were also at relatively better margins compared to the standard transformer oil.

On the export side, the company has continued to grow. We received some very critical approvals, one from the Saudi electric company which covers their transmission and distribution networks. In fact, in November, we are expecting to also have the approval in place for generation. And Saudi Arabia is a largest market in the Middle East and the fourth largest market in Asia. Besides that we received global approvals from GoodYear and I've already started supplying specialty rubber process oils to various units of Good Year.

As far as our automotive products which is the AGIP brand automotive lubricants is concerned the business has also grown with our second quarter numbers coming in at about INR 30 crore and a profit of about INR 1.3 crore. However, we expect a much better second-half in terms of both top line as well as profitability with price increase taking place effective 1st November. And, finally in terms of operations at Uniflex. Uniflex, in the second quarter actually has done a turnover of about INR 105 crore and had positive EBITDA with finally a net loss coming in at about INR 2.5 crore, of which, INR 1.5 crore is depreciation. And the interest cost which we had in Uniflex was about INR 3.8 crore. So we actually had a positive EBITDA for the first time in several quarters. The company continues to focus on improving plant productivity as well as mix of products Uniflex is manufacturing. And also in the quarter we executed the largest ever high tension cable order which came to us through Engineers India Limited for Mangalore refineries which was worth INR 37 crore. It's the largest order that Uniflex has ever executed. We are pursuing through BIFR the merger of Uniflex into Apar. And I think it's reached a point where the operations of Uniflex are starting to now show much better performance. So with that summary I would like to throw it open for questions.

Moderator: Thank you very much sir. Our first question is from the line of Madan Gopal from Sundaram Mutual Fund. Please go ahead.

Madan Gopal: : Sir I just missed out on the numbers of the total order inflow during the quarter.

Kushal Desai: On the conductor side, order book stands at INR 1157 crore at the end of the quarter and we receive INR 332.7 crores of orders during the quarter, of which, INR 117.5 crore came from export markets and INR 215 crore from domestic.

Madan Gopal: Okay there is nothing like on the order book in the transformer side, right?

Kushal Desai: No that is more of a flow.

Madan Gopal: Okay. Sir just wanted to understand the domestic order flow which is come for the conductor. Where it is come from, is it ECB or mostly from private sectors?

Kushal Desai: In the quarter itself there were no orders which came either from Power Grid and less than 5% of the orders came from the ECB.

Madan Gopal: Okay mostly private sector?

Kushal Desai: Yeah, it's come from the turnkey operators and utilities from the export market. Directly from utility or from turnkey operators and largely in the domestic side it's from turnkey operators and big chunk from actually some of these build own and operate projects. So it's the private transmission lines projects that are coming up.

Madan Gopal: Only two companies have so far gone, one is Sterlite and another is Reliance. So is that come from?

Kushal Desai : We received some further orders from, from Reliance and Adani. We have orders also from Jayprakash for one of their projects.

Madan Gopal: Sir just wanted to understand better on how we bid for PGCIL orders. I have mostly seen you building along in a JV with Gupta cables. Any reason why we do it and if it is so how do we share the order between us and Gupta?

Kushal Desai: We bid on about INR 2500 crores worth of projects. All of them have been bid by us on an individual basis as far these INR 2500 crore is concerned, these are tenders which were floated by Power Grid or rather opened by Power Grid November 2009 onwards. So for almost a year there is been no award from Power Grid of any size. And this is because of a backlog that Power Grid has been having on its capital work in progress, which as per the information we have is almost INR 19,000 crore as of the end of 30th September. They are looking and trying to clear off these in the next three to four months. However, given that there is a lot of backpressure starting to come with the power projects under execution, our indications are that these tenders should start getting finalized December onwards. In addition to that I mentioned during the call that another INR 2500-3000 crore worth of tenders have been already identified by Power Grid. And some of the dates have been announced for them which from December 2010 run up to April 2011.

Madan Gopal: Sir just wanted to know, going forward would we mostly bid it on individual basis?

Kushal Desai: Yeah we will largely bid on individual basis. There have been some packages where in the past where we may have bid in consortium or in a joint-venture, because some of the lines covered, the east and central India, we have had a partner who picked up the eastern portion and we picked up the central India portion. So there were certain compulsions in the past to be more

competitive. But as far as the current tenders are concerned, we will be bidding on our own.

Madan Gopal: Sir what is the volume in the power conductor segment? I understood that it has gone 14%. But can you give us the number?

Kushal Desai: In terms of volumes we executed, we've executed about little over 23,000 tonnes in this quarter and just a little less than 50,000 tonnes for the half-year. We are pretty much on a track to do 100,000 tonnes which we projected for the year.

Madan Gopal: And the carry gives us the realizations per metric tonne for conductor?

Kushal Desai: It's in the range of about a lakh and 25,000. It varies with the price of aluminum. Because they are all on variable price, all the domestic orders are on variable prices.

Madan Gopal: So EBITDA per tonne would remain the same?

Kushal Desai: EBITDA per tonne it's a pass through increase in cost or decrease in the cost as the case may be.

Madan Gopal: Okay. Just a very basic fundamental question. I just wanted to understand more on your business revenue flow structure. How does the revenue come for in transformers oil business, is it just like transformer oil is replaced every year and if for a particular 765 KV transformer how much of oil will be consumed in a year?

Kushal Desai : There is the first fill that takes place which would last for upwards of 15 years. But replacement that happens of 5-7% or a top-up on an annual basis. It's typically 5-7 years transformers are taken in for major overhaul and usually the oil is also replaced at that stage and is downgraded to be used in the lower voltage transform. So from oil supply standpoint again the opportunity comes for supplying the product at that point.

Madan Gopal: So is basically year-on-year is the replacement 5-7% of the total oil that is repetitive?

Kushal Desai: Yes.

Madan Gopal: And what can be this percentage in a single 765 KV transformer in kilolitre basis?

Kushal Desai: A typical transformers requires, at the moment the transformer requires about generally 70,000 liters. And the reactor requires about between 35- 50,000 depending on its design.

Madan Gopal: Okay 30 to?

Kushal Desai: 35,000 to 50,000.

Madan Gopal : Out of this 5-7% would be replaced every year?

Kushal Desai: Yes, but that's true across the bond. Its across-the-bond for all types of transformers. Not that 765 KV. To entire installed base in the country you need 5-7% top up on annual basis.

Madan Gopal: Any roughly numbers of installed transformers numbers of transformers in MVA, total?

Kushal Desai: I don't have number handy here. But you require about 15 MVA of transformation capacity per megawatts for whole chain. Generation, transmission and distribution put together.

Madan Gopal: : Thanks for taking my question. If anything there I will get back to you.

Moderator: Thank you. Our next question is from the line of Mayur Parkeria form Wealth Management. Please go ahead

Mayur Parkeria: Thank you for taking my question. Sir very basic question, in annual report, we normally disclose the finish product in transformer oiling in metric tonne and in the quarterly release we have in liters. How do we convert this tonne into liters?

Speaker 1 20.29: We have given liters also in annual report.

Mayur Parkeria: No liter but density if you can?

Kushal Desai: Typically the density of the oil is about you multiply by 0.83 or 0.84. That's a conversion factor.

Mayur Parkeria: Okay, so then one metric ton would convert into 0.83 liter.

Kushal Desai: No 1 metric tonne you divide by 0.83 and that will give the kiloliters.

Mayur Parkeria: Okay. The conductor business has, if you look at two years back they were at the margin levels of around 7.5% to 8%. And right now we are at a much relatively lower level. I understand there has been some low margin and we have given an indication that as we move towards FY12, we will move to higher margins. But do you see them coming back to 8%?

Kushal Desai: Yeah that is what our expectation is. That the margins will come back into that 8% range and it will be driven basically by also a very strong tender flow, requirement flow that will happen. Fundamentally, a lot of power projects which have reached financial closure. Almost 40,000 megawatts of power projects have reached financial closure which are under execution and a big chunk of them are coming up at the end of 2012-2013 and early 2014. And the transmission lines are typically they start the work 18-24 months prior to evacuation of power. With the conductor requirement being towards, year and half prior to the power evacuation taking place. Some of our business is a little bit back ended and given that fact we are expecting from 2011 middle onwards a lot of business volume to come up.

Mayur Parkeria: Okay, So basically from the first half of FY12 itself will start seeing margins coming back on track?

Kushal Desai: Yeah some of the order books which we already have, have a margin expansion. But those are getting executed largely of February 2011 onwards.

Mayur Parkeria: Okay. Just one very slightly longer term question on

understanding. We are exposed to on one side on the global-metal side of the commodity price cycle the risk in terms of our input cost. On the other we have another oil as one of the based that impacts. Obviously, there has been lot of spikes in terms of the volatility. But otherwise also there can be a decent range of volatility which can still persist. Over the longer term how do you see? Are we taking any steps in terms of mitigating the long-term volatility within this structure so that margins are more sustainable and maybe even slightly improved on that side?

Kushal Desai: As far as conductor side of the business is concerned, we are completely hedged. So when the orders have variable price which we buy as per formula and when fixed-price we take hedge on the LME to cover both metal as well as the currency. So from that stand point the conductor business is pretty much de risked in terms of fluctuation in the metal. We want to be agnostic of whatever the metal fluctuations are. As far as the oil business is concerned we've completely moved ourselves to either quoting for government tenders on the EEMA price variation formula which captures base oil movement, foreign exchange movement and the moment that happens in custom duty. Or we price it by the month, in which case we take into account these factors. Besides this, there is no other level of mitigation as possible. But we believe that by doing this we are in the position to minimize the risk.

Mayur Parkeria: 60% of our input is broadly imported.

Kushal Desai: : 90% in our oil business.

Mayur Parkeria: Yeah 90%. But in terms of sourcing arrangement are in terms of any other..

Kushal Desai: Yeah, we have long-term sourcing arrangement in place. For about 70% of the base oils that we buy, but the pricing on that fluctuates basically with market related parameters.

Mayur Parkeria: Okay fine.

Kushal Desai: : And when we pretty much pass that on to the marketplace.

Mayur Parkeria: Sir, just one highlight on this year and the next year's CAPEX levels if any?

Kushal Desai: Yeah we have a total CAPEX plan of about INR 85 crore which will run through this year and into next year. So by the end of FY12 most of this CAPEX would have come on-stream.

Mayur Parkeria: Okay thank you very much.

Moderator: : Thank you. Our next question is from the line of Vishal Saraf from SBI Mutual Fund. Please go ahead.

Vishal Saraf : Hi sir. Congratulations on the great set of numbers. Primarily, I wanted to understand on the transformer oil segment because this is where we are seeing more traction and better margins. So, can you just help me understand how much revenue we would have generated during the quarter from EHV transformer oil segment?

Kushal Desai: We did over 35% in the EHV segment in the last quarter because there was a number of 220 and 400 KV jobs that got executed in spite of it being during the monsoon months. The first sets of 765 KV transformers also were delivered in that timeframe and the oil was delivered for those transformers in that timeframe. We also actually grew the distribution transformer oil side of the business. Because the margins there were better than in the case of white oil. And some of the raw materials are fungible at the low end of the transformer oil side and technical grade white oil.

Vishal Saraf: And how much, you said 35% of the transformers oil segment and out of the overall oil segments how much would this revenue from EHV be?

Kushal Desai: The transformer oil itself is about 45% of the entire sales. So you take basically 35% or 45%, we're looking around 13-14% of the oil segment.

Vishal Saraf: And how much of this would be revenue from the 765 KV segment?

Kushal Desai: That's relatively still small, we executed approximately about 5% so it's about 1000 kiloliters that got executed in the last quarter.

Vishal Saraf: : And what will be the realization probably to get a sense of absolute revenue or something?

Kushal Desai: It's a completely different format that is involved for that base oils and everything is completely different. So typical distribution transform oil if it is in the range of about INR 47-48 a liter. This product would be on the Rs 62-63 a liter range.

Vishal Saraf: And what do you see the potential market for 765 KV transformer oil?

Kushal Desai: Actually the market is huge. That is going to come up primarily within the portion of execution in the XI five year plan where we are expecting approximately 5700 circuit kilometers of that. Now all those orders are being executed from now onwards. There is almost nothing that's gone in the XI five-year plan of 765 KV so far. So it's all coming in the last two years of the plan and then in the XI five-year plan we are expecting 25-30,000 circuit kilometers worth of orders. So the market for this is really just beginning. So these are baby steps compared to what should happen in the next 5-6 years to come. And at the moment we are the only Indian company that has been approved for 765 KV by Power Grid.

Vishal Saraf: But what should prevent other guys from entering into the competition?

Kushal Desai: They have to go through and complete the testing through Power Grid.

Vishal Saraf: : Right, but they would have already started the process and ...

Kushal Desai: Our Indian competitors in the first round of testing their products fail, whereas our product has passed through. We've also got

approvals from all the major OEMs so we have approvals from Areva, ABB and Siemens for 765 KV.

Vishal Saraf: And they all would again require separate test?

Kushal Desai: The same sort of test but approvals are required in stages, one is from the utility and then the transformer OEM because the transformer OEM is the one that actually giving the warranty on the product. So have actually approvals in place at both levels.

Vishal Saraf: And others would have approval either.

Kushal Desai: Others are not having approval at either level at this stage.

Vishal Saraf: Okay, but they are in the process. So how long do you think will be the tender 6 to 8 months for them to get all these approvals and....

Kushal Desai: At least is you know if the product is meeting the specs.

Vishal Saraf: Okay, so you do not see the products meeting the specs in this quarter.

Kushal Desai: I think we have a head start on it at the end.

Vishal Saraf: Yeah that is very clear that we had a head start but you know I was just trying to figure out whether it can be a very long start this year or just one year kind of head start.

Kushal Desai: It is a little difficult to tell because the formulations and you know the products itself is very tricky to manufacture, so to give you a perspective worldwide, there are only four companies that have products that meet 765 KV, one of them is Petrochina from China that is basically not active outside of China at the moment and then there are two other international companies besides Apar.

Vishal Saraf: Okay, so just four players. So the other players if they are not able to establish their product then they will also need to go only to these two to three guys to get technology, otherwise it is very difficult to get technology.

Kushal Desai: Yeah, nobody shares the technology actually for this because your value is high, the value-to-volume ratio allows you to shift around the world the products, so I guess most of the other people are restricted to doing lower voltages at this stage.

Vishal: Okay, and you know again to get a broad sense like you said there is huge opportunity for this oil going ahead but on absolute basis, how much scale up do you think can we do in the 765 KV oil segment, can it be a INR 50 crore opportunity or INR 100 crore opportunity and in terms of annual revenues going ahead or can it be even higher than that.

Kushal Desai: See if you actually convert these lines which are there and if we get 100% of the Indian business, then you are looking at revenues which are between 50 and may be 70 or 80 crores per annum on 765 KV. Some of the manufacturers today's OEMs have started using the 765 KV specs and insisting on the same specs to be used for 400 KV also and the 400 KV market is more than double the size of the 765 KV market in India and worldwide 400 KV is a

much-much larger market because there are not too many countries which have networks of a voltage level as high as 765 KV. So the same specs people are starting to insist on the same 765 KV specs even for 400 KV today, that movement also has started, so we again have a little bit of a head start on that. Essentially, on the edge where we have the extra high voltage segment, we have about two-thirds of the market at this stage.

Vishal Saraf: Of the total.

Kushal Desai: We have two-third market share in that segment.

Vishal Saraf: Okay and there is no significant import in the EHV segment, transformer oil.

Kushal Desai: No, there is some amount of import for 765 KV that has happened before we were approved but now with our approval in place, I think bulk of that business, hopefully we should be able to capture.

Vishal Saraf: Okay, and we have been approved with ABB and Areva and those players or they are importing as of now?

Kushal Desai: Well we have been approved. There have some importation that is taking place for orders that were placed prior to Power Grid approving us but going forward, we would expect bulk of the business to come to us.

Vishal: And approval with ABB, Areva and Siemens all the three.

Kushal Desai: Yeah, we have formal approvals in place for all three.

Vishal Saraf: Okay, and sir just one more point on the oil segment you know this quarter we have seen the realization growth to be very high compared to the volume growth, so what was the reason for this, it is just the oil price movement or....

Kushal Desai: No the realization has grown largely because of the change in the mix of the product. We sold a lot more transformer oil relative to white oils where you know the transformer oil margins are higher, also within transformer oils, we have sold more EHV grade transformer oil and we expect this trend to continue over the next few years because the amount of transformer oil going in for 400 KV, 765 KV and all that will continue to increase.

Vishal Saraf: But still see if you look at, revenues have grown up by 38%, where as volume is up by only 3.5%, so it means a 35% realization growth for the quarter in the oil business, so the entire 35% is.....

Kushal Desai: No, there is one portion which is because the oil prices generally have gone up but there has also been a change in the mix of product. We have sold more transformer oils in this quarter than we have pulled white oil.

Vishal Saraf: So, what will be the proportion of transformer oil to white oil?

Kushal Desai: Our growth in transformer oil is almost 40% in the first half over the same period previous year.

Vishal Saraf: 40% in transformer oil.

Kushal Desai: Yeah and we grew our white oil business by almost 20% odd.

Vishal Saraf: 20% degrowth it is.

Kushal Desai: Yeah.

Vishal Saraf: This is the AG brand.

Kushal Desai: No white oil.

Vishal Saraf: Okay and how is the realization difference between transformer and white oil broad price number?

Kushal Desai: Transformer oil is more profitable than white oil, that is the primary reason why we actually had the opportunity to grow even on the distribution side of transformer oil....

Vishal Saraf: In realization like you said you know transformer oil would be say INR 46 to 47 per liter, what will be the price of say white oil?

Kushal Desai: It is almost about INR 2 cheaper than that whereas the cost basis is almost about the same.

Vishal Saraf: Right, but see you again when we are seeing that price differential between transformer oil and white oil is say 4%, so with 3% volume growth and close to 38% revenue growth, there is still at least 20 to 25% of this growth would have come on account of higher realization which is the base oil prices itself.

Kushal Desai: Yes absolutely but the profitability increase has come largely from the change in the mix of product.

Vishal Saraf: Okay and not because of price movement.

Kushal Desai: No because the price movement is like almost has passed through, so the real driver to the higher profitability has been the improved mix and we expect the transformer oil mix to continue to remain strong you know. With more buyers towards the EHV transformers as we execute through you know the next few years.

Vishal Saraf: And sir in the conductor segment how do you expect margins here on do you expect current level of margins to continue or....

Kushal Desai: You know that towards from February onwards we have orders which have higher margin based on the order book itself which we are carrying at the moment, so you will still have third quarter where the margins will be in this sort of level and then from the fourth quarter onwards, the margins will start showing improvement and then FY12 we see substantial improvement in the profitability.

Vishal Saraf: So, what kind of margin improvement do we expect this quarter-on-quarter?

Kushal Desai: I think in the course of the next 12 to 18 months, we should get closer back to 7-8% margin levels.

Vishal Saraf: Okay but given the way competition is increasing and all other players are also increasing capacities, do you think structurally this industry is headed for lower margins because we have been looking at some of the

competitors and they have been also in couple of higher competition increasing capacities and lower margins.

Kushal Desai: A lot of it also depends in terms of who your customers are and primarily we see that once the order books are good then people bid on business which they have better margins in terms of the incremental orders which come in, this is what we have seen going forward and we expect the demand to itself be very strong, so there is a huge bunching of orders, a lot of this has been delayed by a couple of years. I just mentioned about Power Grid for example, you have 2500 Crores worth of tenders that they have opened that they need to place the orders on. On top of that we have to float another 2500 Crores worth of tenders in the five month period from December to April, so a lot of the pace of this activity is really picking up because the power projects are coming up.

Vishal Saraf: But these INR 2500 crores of orders which are pending over last 9 months would be total order or is it just the conductor?

Kushal Desai: This is only conductor I am talking about.

Vishal Saraf: Pure conductor value.

Kushal Desai: In fact, the tower packages in this November, they have start awarding the tower packages. The board meeting of Power Grid that happened in November the tower packages our understanding is that they have taken on the tower packages, the conductor normally follows by about typically 6 months but I think this time the cycles will be much shorter, it will be closer to 3 months gap.

Vishal Saraf: Okay sir, that is it from my side.

Kushal Desai: Thank you.

Vishal Saraf: Thanks a lot.

Moderator: Thank you. Our next question is from the line of Pranav Gokhale from Religare Asset Management, please go ahead.

Pranav Gokhale: Good afternoon sir.

Kushal Desai: Yeah good afternoon.

Pranav Gokhale: Yeah, what could be the total market for conductor in India be like in terms of MT or what will be the capacity in metric tonnes basis.

Kushal Desai: The market at the moment is in the range of about 600,000 tonnes total.

Pranav Gokhale: Okay.

Kushal Desai: And we expected to be growing in the range of about 15% per annum basis.

Pranav Gokhale: And what could be the capacity as such for the entire this thing would be around the same.

Kushal Desai: I have got it wrong. 500,000 tonnes is the market and about 600,000 tonnes is the current capacity.

Pranav Gokhale: And are these capacities fungible when it comes to conductors of higher scale or higher voltage or is it.

Kushal Desai: Not necessarily, in fact a lot of people are having a substantial amount of capacity for distribution conductors as oppose to for the transmission conductors, it requires completely different machinery in place, also not all the capacities actually approved to be supplied for you know people like Power Grid and most of the private operators today are going by Power Grid's approval you know, so they are discussing usually with the suppliers who got approvals from Power Grid.

Pranav Gokhale: Sir the question is if there are two players who will have a substantial share of the market say about 50% of the total market and higher income to transmission conductors then why is not price discipline maintained which we have seen over the last 3 to 4 years as such.

Kushal Desai: See, there was a period where actually, the kind of numbers which Sterlite or Apar has had in terms of volume, it has not necessarily been reflected with some of the other conductor companies, simply because we are in a position to participate pretty much in every single requirement that has been out there whether it has been Power Grid or whether it has been turnkey operators or build-on an operate projects, so the total volume that was available to be bid of conductors in the last couple of years actually had fallen much below the 500,000 numbers which I am talking about because of these delays that took place from Power Grid side in terms of awarding as well as some of these financial closures on these private projects have also happened only towards the end of 2009 and early 2010. So, there was a period where there was very little activity on the tendering front meaning on the demand side, so that is what has resulted fundamentally in some of these orders coming in at relatively lower margins for us.

Pranav Gokhale: But in that case, are the 11th plan orders from Power Grid basically over or are they....

Kushal Desai: No, in fact, there is a big chunk of them left, as I said INR 2500 crores is the tender which we have already opened, which we expect the orders to be awarded from December through to March and then another INR 2500-3000 crores worth of tenders for conductors alone which Power Grid has sort of prepared and they have given some of the dates also on which these tenders are expected to open. I believe is that demand will only actually increase from year going forward with particularly from second half of 2011, it is picking up at a more rapid pace.

Pranav Gokhale: But the realization part metric tonne per tonne....what you have seen which has gone down say from 2006-2007 levels? Would you see that kind of adding up, I mean, commodity prices is different thing but....

Kushal Desai: Yeah, that is what we expect with the higher order books coming in.

Pranav Gokhale: Okay, so you will have your gross margin per tonne increase steadily as well.

Kushal Desai: Gross margin per tonne we expected for it to increase to go back to similar levels as what it was in 2007 and 2008.

Pranav Gokhale: Okay sure sir, the other question is the cash which we are carrying. The cash and bank balance is as on the balance sheet debt reflected an amount of close to INR 488 crores. The debt number which your balance sheet reflected a total was about INR 160 odd crores. Hello. So there is a net cash of INR 320 crores and despite that....

Kushal Desai: Of that actually INR 80 crores is free cash flow and about INR 400 crores as of March 31, 2010, has actually tied up again certain LCs and bank guarantees, etc.

Pranav Gokhale: Precisely that is the question. Now this INR 400 crores of bank guarantees could you just explain in detail as what these bank guarantees are about and why this INR 400 crores amount is being tied up or locked up for these kind of guarantees.

Kushal Desai: There is a small portion for guarantees are much larger portion is attached to letters of credit.

Pranav Gokhale: Okay, this is with respect to the transformer oil.

Kushal Desai: Importation yeah particularly either transformer oil or in some cases even aluminum which we have imported.

Pranav Gokhale: Okay but.

Kushal Desai: You know the easy way to look at it is you look at net payable so you have current liabilities which are about INR 1100 odd crores and you reduce this INR 400 crores of cash which has tied up again. It shows the net payables are really about INR 700 odd crores and INR 80 crores is free cash flow. That is a much simpler way of looking at it, just the accounting standards requires you to reflected in this fashion.

Pranav Gokhale: Okay, no but these bank guarantees which one has to play, so if you execute any contract or have a transformer oil.....

Kushal Desai: No, bank guarantees are particularly tied to the conductor business, where you first give a bank guarantee for execution of the order which is typically 10% of the order value and after the order has been executed it gets converted into a performance guarantee for about 18 months.

Pranav Gokhale: Okay and for that you will have to maintain about 20% of the overall guarantee value as the margin money.

Kushal Desai: It is not necessary, basically we keep margin money which is you know 5% or below. Most of this money is actually tied up against letters of credit which are going to fall due and we have deposits against those letters of credit which would fall due.

Pranav Gokhale: Okay, but letters of credit is basically the transformer oil business....

Kushal Desai: Well, I mean it is a mixture of both but it is more I think it is almost 70% transformer oil and 30% conductor.

Pranav Gokhale: Sir, and this purchase cycle for transformer oil is what quarterly, every 3 months.

Kushal Desai: 180 days.

Pranav Gokhale: It is 180 days.

Kushal Desai: 180 days letter of credit.

Pranav Gokhale: So it get revolves twice in a year.

Kushal Desai: Yes.

Pranav Gokhale: Okay, now going ahead if you expect similar sort of growth happening in 15% to 20% which you are talking about in absolute term also this amount will keep on increasing?

Kushal Desai: In absolute term, yeah, the total amount of LCs that you require will increase.

Pranav Gokhale: Yeah, so does it affect your free cash flow in any way, that is what my question.

Kushal Desai: It should not affect our free cash flow.

Pranav Gokhale: Okay sure, thank you sir.

Kushal Desai: Yeah.

Moderator: Thank you. The next question is from the line of Punit Chokhani from Enam Securities, please go ahead.

Punit Chokhani: Yeah, good afternoon sir.

Kushal Desai: Hi, good afternoon Punit.

Punit Chokhani: Just stressing back on margin for conductors, you mentioned you are carrying an order book which has largely got higher margins than what we have executed last year but you also mentioned that large part of this order book would be because of probably private sector orders from turnkey or asset owners. What I want to understand is the fact that you have mentioned that we expect margin expansion going forward stressing on the fact that you know large amount tender bids are going to open up from Power Grid, are you expecting that margin expansion is going to happen because you are going to be executing or providing more of high temperature conductors or high voltage conductors or is it the same level of conductors that you have been providing in the past than what is going to lead to this margin expansion for the same level of conductors.

Kushal Desai: Okay, let me answer in this way. Our order intake in the last quarter has come largely from the build own and operate and private jobs. Of this, INR 1157 crores we have still over approximately INR crores worth of orders from Power Grid, but the delivery schedules of those are deferred with the large portion of it coming in basically post February of 2011 onwards. So, the margin expansion which we are expecting is basically 2011 onwards. Some of the ordering has been a little bit more delayed and once these Power Grid orders are awarded with people's order book relatively full margins are likely to

improve. Some of these tenders have been opened and some of them the technical bids are open, the financial bids still need to be opened but the expectation is that once these INR 2500 crores worth of orders have been placed, then most of the key players in the industry would have significantly improved order books. So, when you start bidding on fresh business then you know you are obviously more choosy in terms of the business that you bid on that reflects itself in the margins. So what we are talking about at the moment is not just coming from the high temperature conductor. These high temperature conductors will still continue to be a relatively small percentage in FY12, we expect the business for that will really pick up you know in FY13, FY14.

Punit Chokhani: Sure, so what you are saying necessarily is that you are going to be bidding in these tenders with higher margins as such.

Kushal Desai: That is what our expectation is, not ourselves where as others as the order books increase, tendency then is to Quote with higher margins.. The average EBITDA at the moment is 5% at the segment level, whereas historically we operated at 7-8% less compared to....

Punit Chokhani: Sure, okay, no because just as Sterlite take I mean being the probably the largest guy along with you, I mean they are in the same business and looking at the way their order book is shaping up and what expectations that is the reason I asked this question to you but okay fair enough. Secondly, just one more question pertaining to transformer oil, you said around 5-7% of the oil in the transformers are generally what is replaced every year, is that right.

Kushal Desai: Correct.

Punit Chokhani: So just if you can give me a picture of I mean of the transformer oil sales that we do in terms of volume or sales, how much portion would be for this replacement.

Kushal Desai: See we are at the moment running at about 80% first fill and 20% replacement and our focus on the replacement market at the moment is largely again in the power transformer and I mean for mid range power and EHVs power, because the competition there is also relatively less and the specifications are much higher. Where we find the lowest realization in the transformer oil segment is basically the tenders of the SEBs for the distribution transformers, so we basically focus more on the OEM segment for distribution and then across the board for the mid range power and EHV power.

Punit Chokhani: Sure. Thanks a lot.

Moderator: Thank you. Our next question comes from the line of Sanjeev Zarbade from Kotak Securities, please go ahead.

Sanjeev Zarbade: Yeah, thank you for taking my question sir. I just wanted to understand our CAPEX plan that you have outlined of INR 80 crores, where is it going and what kind of capacity addition we can expect from this?

Kushal Desai: Yeah, in terms of our CAPEX, we are planning to invest about

INR 50 crores on our conductor business, that includes INR 15 crores in one of our existing plants at Silvassa, so it is a Brownfield expansion where the capacity should increase by 10,000 metric tonnes. So our current capacity in conductors is 115000 Mt. and it will go to 125000 Mt. and then we are looking at a Greenfield plant where we are looking at expanding our capacity by a further 30,000 metric tonnes at a capital outlay of about INR 35 crores. So, at the end of that, we should be at 155,000 tonnes, with a INR 50 crore further investment. In our oil business, we are looking at a CAPEX of about INR 15 crore, and that is largely for debottlenecking some of the grades of products that we manufacture including being able to manufacture more 765 KV and 400 KV transformer oils. Then we have a plan of investing about INR 20 crore on a new technology which is called **electronbeam curing**, which is largely to be used for, you know, the cable business that we have; this basically produces cables with very high insulation capability relative to conventional cables and it is a relatively higher value-added product. So, together, all this is comprising about INR 85 crores.

Sanjeev Zarbade: These greenfield plants would come in the fag end of the next year probably.

Kushal Desai: The greenfield plant should come in the last quarter of FY12.

Sanjeev Zarbade: Okay and fundings should be through routes of internal...

Kushal Desai: We are planning to actually fund it largely through equity and look at fund raising through a qualified institutional placement (QIP).

Sanjeev Zarbade: Okay great sir, no problem and all the best for the future.

Kushal Desai: Thank you.

Moderator: Thank you. Our next question comes from the line of Madan Gopal from Sundaram Mutual Fund, please go ahead.

Madan Gopal: Hello sir, I have one followup question, are we approved with Crompton Greaves.

Kushal Desai: Yeah, in fact they are one of our largest customers.

Madan Gopal: So far, billing around 20 of 765 KV transformers have been awarded in India, of which, how many we would have filled so far?

Kushal Desai: Transformers are going to have delivery coming up from the end of this quarter beginning of next quarter onwards, they are all for a project of UPTCL, which is Uttar Pradesh Transmission Company. So those transformers are still to be delivered.

Madan Gopal: So, so far, we have not done any....

Kushal Desai: Already received an order from Crompton Greaves for the first set of transformers, but I think the delivery of that is going to happen only towards December or January.

Madan Gopal: How many transformers we will be filling in this.

Kushal Desai: At the moment, we, I mean I do not have the exact number

with me but at the moment we are pitching on the entire business of that you know, the entire set of 765 KV transformers they would supply.

Madan Gopal: Okay sir, thanks for taking my question.

Moderator: Thank you. The next question is from the line of Vishal Saraf from SBI Mutual Fund, please go ahead.

Vishal Saraf: Hi sir, just a small clarification on all these Power Grid conductor projects where we did have bid over past 8 to 9 months, you know when these orders have finally executed or order two was, how does the price escalation works do we get?

Kushal Desai: It is a variable price, so the pricing formula is it is average of 3 months prior to the date of delivery.

Vishal Saraf: Right, but we get escalation only on the basis of price only after the order is given to us and then the date of execution.

Kushal Desai: No, there is a very clear price variation formula which is in place.

Vishal Saraf: Right but for formula, the base would be not the date on which we have submitted the bid but the date on which we got the order.

Kushal Desai: No, it is based on the date on which the bid was submitted.

Vishal Saraf: Okay.

Kushal Desai: So price, you know the price that is existing today and as the bid today then I use that as a base and bid on the job and supposing I am awarding the job after one year then whatever delta or changes that have happened in the price of aluminum based on that formula is then reflected. The same thing with steel and zinc, and there is also a labour variation which is in the case of Power Grid based on the index.

Vishal Saraf: Okay, sir we do not expect any sort of impact because you know we would have bid say 9 months back and now the circumstances are different in terms of costing.

Kushal Desai: The only thing that was not covered in the price variation formula is freight, otherwise, it covers everything, it covers basically labor, it covers aluminum, steel and zinc.

Vishal Saraf: Right from the day of bidding to the date of.....

Kushal Desai: Date of a particular delivery, because the delivery is also staggered no.

Vishal Saraf: Right and right from the date of bidding?

Kushal Desai: Yes.

Vishal Saraf: Okay sir that is it from my side. Thanks.

Kushal Desai: Thanks.

Moderator: Thank you. Our next question is from the line of Divyata Dalal from Mangal Keshav, please go ahead.

Divyata Dalal: Good afternoon sir, I just wanted to get a sense of your interest cost, it has turned negative this quarter, so and if we see on the balance sheet size, the total loans component has increased so just wanted to get a sense out of this.

Kushal Desai: Well, actually, the interest cost has been lower simply because we have had again some of these LCs, we put actually fixed deposits, so as a result the interests which we have got from the fixed deposits is higher than the interest that was paid, now also you know the foreign exchange is a 180 days credit which we take, there are really three components to the cost, there is one portion which is bank charges which are pertaining to the opening of the letters of credit, etc. So that is not captured under interest that is captured separately under bank charges. Then interest is actually just the LIBOR and the premium which you are paying and then the third component is the hedge cost which is taking the forward cover between dollars and rupees. So that hedge cost portion also is picked up, you know, in the cost of the material under the accounting standards. So, really, with the interest that you see there is pertaining only to the LIBOR rate of interest plus the premium which we are paying, so it is about 2% on the outstanding LCs that we have. In addition to that we had almost INR 400 crores of margin, which we are putting, so we are getting a fixed deposit rate of interest. So when you net-net take out it is almost they neutralize each other. In addition to that you have the bank charges and the forward cover cost which are picked up elsewhere.

Divyata Dalal: That is picked up in the raw material price.

Kushal Desai: Yeah, so it comes out of the operating margin actually.

Divyata Dalal: Okay, so essentially this would be the scenario going ahead also, this would....

Kushal Desai: Yeah, this is the scenario that will be there. Based on the accounting standards, this is the way costs have picked up.

Divyata Dalal: Okay, fair enough, thank you sir.

Kushal Desai: Yeah, you are welcome.

Moderator: Thank you. Our next question comes from the line of Rajeev Ghosh from Wealth Management, please go ahead.

Rajeev Ghosh: Good afternoon sir.

Kushal Desai: Yeah, good afternoon.

Rajeev Ghosh: Sir, can you say that out of the 23,000 tonnes, sir can you give me the breakup of the transformers in terms of volumes?

Kushal Desai: See, our oil segment as such we ended up doing about 64,000 kiloliters as a whole, for the quarter 131,000 for the half year.

Rajeev Ghosh: Can you break it up into transformer and other specialty wise?

Kushal Desai: About 32,500 kiloliters is transformer oil for the quarter.

Rajeev Ghosh: Okay and sir what is the % of total oil...

Kushal Desai: Approximately half.

Rajeev Ghosh: And the other segment is you know in your annual reports you gave it as specialty oil in pharmaceuticals, what is that I mean, I cannot quite understand.

Kushal Desai: We have white oils and pharmaceutical oils. There are five categories, transformer oil is the largest then we have white oils and pharmaceutical oils, rubber process oils and then we have automotive oils under the AGIP brand name and we have industrial and process oils.

Rajeev Ghosh: And sir the margins are best in transformers.

Kushal Desai: Margins are highest in transformer oils and industrial lubricants. These are the two categories where the margins are higher.

Rajeev Ghosh: Sir, do you think that the margins can be sustained at these levels for transformer oil?

Kushal Desai: Look, we believe that the margins, what we have achieved in the first half that is pretty much what we should be able to do going forward and then depending on the quarters in which there is more shipment of some of the higher-end products going to 765 KV, etc., the margins will be like in the last quarter. We did quite a lot of special jobs and, going forward, we expect more and more of these special jobs to come up. So, the sustainability in margins is quite possible.

Rajeev Ghosh: Okay, sir do you think that around 10,000 kiloliter is the market demand expected for 765 kilowatt transformers?

Kushal Desai: The requirement will vary from 10,000 and build right up to about 15,000 kiloliter in a year. That is the reason why earlier you know I had mentioned that we expect sales to range between 50 crores and then anywhere between 75 and 100 as more and more of the 765 KV goes in.

Rajeev Ghosh: Okay, so what can be the volume growth that you can expect for transformers in the next couple of years?

Kushal Desai: We are looking at +15% growth year-on-year.

Rajeev Ghosh: 15% growth.

Kushal Desai: Yeah.

Rajeev Ghosh: And the press release shows that we are planning for debottlenecking, how much will it take your capacity up to?

Kushal Desai: See, actually we already have a capacity in place which is over 300,000 kiloliters, it is almost 330,000 kiloliters in place. So, most of the investment is going into making the capacity more flexible as well as there is investment going into improving our testing infrastructure because there is a lot more of the high voltage oils which are going out, so some of the diagnostics testing, etc., which needs to be done that is all being that infrastructure is being invested in and improved.

Rajeev Ghosh: Okay sir, thank you sir, very much.

Kushal Desai: You are welcome.

Moderator: Thank you. As there are no further questions, I would like to hand the floor back to Mr. Rahul Gajare for closing comments.

Rahul Gajare: I would like to thank the management for sparing the time on the concall and I wish the management very best on the following quarters. Thank you and all the best sir.

Kushal Desai: Thank you.

Moderator: Thank you. On behalf of Edelweiss Securities Limited that concludes this conference call, thank you for joining us and you may now disconnect.