Apar Industries Limited
Q2 FY18 Earnings Conference Call
November 02, 2017

Moderator: Ladies and gentlemen, Good Day and Welcome to the Apar Industries Limited Q2 FY18 Earnings Conference Call, hosted by Four-S Services. As a reminder, all participant 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 should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. At this time, I would now like to hand the conference over to Ms. Nisha Kakran of Four-S Services. Thank you and over to you.

Nish Kakran: Thank you. Good Evening, everyone. On behalf of Four-S Services, I welcome all the participants to Apar Industries Q2FY18 Results Conference Call. Today on the conference we have Mr. Kushal Desai – Chairman and Managing Director, Mr. Chaitanya Desai – Managing Director and Mr. V.C Diwadkar – CFO, Apar Industries. I would now like to hand over the call to Mr. Desai for his opening remarks.

Kushal Desai: Thank you, Nisha. Good evening, everyone. A very warm welcome to the Q2 FY18 Earnings Conference Call of Apar Industries. I would like to begin the call with bringing out a few of the industry highlights and the status of the industry as we see it today. And then follow that up with the quarter's performance. Post that we can throw open the floor to questions.

So, in the quarter gone by there have been some further announcements and measures that have come forward from the government for the power sector. Especially with respect to the transmission and distribution side, in the last month the government launched a scheme called the Saubhagya Scheme for which Rs. 16,000 crores have been allocated, under which households across the country who do not have access to electricity will be given free power connections. This scheme is expected to improve energy demand and benefit the capital goods industry. Additionally, the government is working on new norms for power purchase by electricity distribution companies that hopes to revive demand for power purchase agreement (PPA). The long-term PPAs have started drying off due to weak industrial power demand and fairly tepid off-take. If the new norms are enforced there will be more flexibility with the DISCOMS since they no longer need to pay a fixed cost to a power generating company. They will only pay for the power which is being bought. This measure may actually end up improving the health of some of the DISCOMS, especially given the lower off-take of power that they are seeing.

Though the long-term prospects of the industry still look good, especially for the transmission and distribution segment, the quarter gone by actually witnessed a number of not so good things, including lower ordering on account of uncertainty around GST, resulting in lower off-take and in some cases increased competition with fairly aggressive pricing. The main sector affected has been the non-conventional energy segment, as several state governments have demanded for renegotiation of power purchase tariffs which have already been closed. There are also issues with respect to executing supplies with this lower GST of 5% for these non-conventional energy projects. For example, the cable that we supply carry a general tariff of 28%, the notification is supposed to allow cables being supplied for power generation in solar and wind to be at the concessional 5%, but there is no mechanism in place to actually deliver this 5%.

As a consequence, the revenue impact on the company's performance has been there, but it was reduced due to a stronger presence on the export front. Revenue for the quarter came in marginally lower, which along with mark-to-market Forex losses and some aggressive pricing that happened for orders that were executed during the quarter impacted profitability. But we believe that it should not last long, it is a transient issue.

However, the company has been facing some amount of cash flow problems on account of IGST. We have paid IGST on duty free raw materials which erstwhile was exempt and until the government announced a measure on 6th of October exempting the payment of the same, a total of Rs. 68 crores has actually got stuck in the system with really no clarity on when it will actually be refunded.

The entire web based mechanism of this whole GST filing, the refunds process, etc., seems to be in quite a mess at this stage. So there are likely to be some adverse implications for industry, especially with respect to cash flow until these issues are fixed. Execution of booked order has also disturbed to some extent due to various government agencies wanting to renegotiate existing purchase orders to capture the benefits of GST. In most cases this now seems to have gotten settled, but it did disrupt activities in the second quarter. In the absence of proper guidelines many departments have complicated and delayed what should have been a pretty simple and straight forward process by applying their own thought processes.

The ongoing quarter has actually started on a better note with key players receiving approximately Rs. 3,000 crores worth of orders in the month of October itself. We expect the second half FY18 to be better for all our segments with the post monsoon execution cycle starting to pick up. Our conductor business has already received a slightly higher order book, the specialty oils business is clearly seeing visible increased demand for the higher voltage oil, while the auto lubes and cable segment have both posted a fairly strong growth.

I will now like to actually discuss some of our financial numbers more in detail. So if you look at the numbers, our consolidated revenue in the quarter came in at Rs. 1,249 crores which is lower than what it was a year ago at Rs. 1,287 crores. This largely came on account of lower revenue from the conductor segment, it was partly offset by a strong growth on the cables front, followed by specialty oils. EBITDA for the quarter declined by about 14% to Rs. 89 crores from Rs. 104 crores in same quarter year ago. This resulted in an EBITDA margin of 7.2%. Profit after tax came in at Rs. 26 crores compared to Rs. 46 crores in a year ago period. This decline in profitability was essentially on account of some of the mark-to-market forex losses, as the value of the rupee declined in the last few days of the quarter and so even though the MTM losses have been picked up we expect to actually recover those in pricing in this Q3 quarter. Also, we had lower volumes of conductors which have contributed to some of this decline. We expect this impact to actually taper off in the next couple of quarters.

Depreciation for the quarter is up 32%, at Rs. 14 crores on account of newly commenced facilities from all the major CAPEX that we have done. Working capital cycle was a bit stretched due to the blockage of funds on account of the GST, as I had explained before.

If you look at our six months period, the revenue for six months is 7% higher than what it was last year. However, the EBITDA is about 15% lower at Rs. 186 crores, resulting in an EBITDA margin of about 7.3% for the period. Profit after tax for the first half came in at Rs. 65 crores with PAT margin of 2.6%.

I would now like to actually go through each of the business segments in a little bit more detail. Our Conductor revenue was down 25% and came in at Rs. 493 crores compared to Rs. 658 crores in Q2 FY17 on account of lower off-take. Part of this was due to GST and part of it was due to slower execution during the monsoon period with a lot of scheduled deliveries actually getting postponed and delay in some of the financial arrangements that need to be made in order for us to start the order execution.

The export side actually continued to do very well, we had a contribution of about 53% coming in from the export segment compared to 42% from a year ago. The order book has come in at Rs. 1,406 crores at the end of September compared to Rs. 1,162 crores as of 30th June. We received a total of over Rs. 700 crores worth of fresh orders in the quarter. The current export orders contributes about 49% of the order book.

As we brought up to your attention in the last quarter that the Chinese metal prices were much lower than LME and that had provided some amount of disadvantage for us. In Q2 the situation reversed and today the Chinese prices and the LME prices are almost at same levels. So the disadvantages which we faced actually has been neutralized and that has helped with increasing the order booking for the quarter. We have also bid a bit more aggressively in domestic tenders, especially considering that our manufacturing will take place from the Jharsuguda plant in Orissa, this has resulted in an increased order flow. However, we have seen that margin for conventional conductors continues to be under some amount of pressure. EBITDA per metric ton post the FOREX adjustment for the quarter came in at Rs. 8,934 compared to Rs. 10,944. So it is about Rs. 2,000 per metric ton lower than the same period previous year.

High efficiency conductor revenue contributed to 12% of the overall conductors revenue. This is also lower than what we would have otherwise liked. It has been partly impacted due to slower execution from the monsoon period. There have also been delays in finalization of some of the high efficiency conductor tenders. None of them have been cancelled so we are in the hope that it should get finalized in the ensuing two quarters of this year.

We have utilized this period the opportunity to shift the balance plant and machineries from Silvassa to the Jharsuguda plant. We believe that the Jharsuguda plant today provides a very strategic location and will substantially make our company's products competitive, especially relative to producers who are located in Silvassa and the western part of the country.

If we take a quick look at the six months numbers, revenue declined by about 10%. The export contribution for the period was 48% and the high efficiency conductor revenue contributed 16% for the first half of the year. The EBITDA per metric ton for the first half came in at Rs. 10,079.

Now, moving over to the transformer and specialty oil side. The revenue for the quarter grew 20% to reach Rs. 505 crores compared to Rs. 420 crores from a year ago. We saw increased sales volume in transformer oil, white oil, industrial lubricants as well as automotive products. The global shipments for the quarter increased by 12% to reach 95,484 KL, so this actually represents historically the highest sales that we have had for the second quarter. This is despite having lower sales in the month of July due to the whole GST implementation which has actually picked up only in August and outperformance in the month of September. In this quarter we also witnessed very significant competition on the pricing front, especially in transformer oil and white oil segments.

There was a very steep decline that happened in the months of June and July on crude, and this resulted in some sort of panic selling from various quarters on particularly distribution based transformer oil and white oils. Since then you have actually seen prices of crude sky rocket, go from a low of about $45 to now in excess of $61 per metric ton. We have already gone ahead and announced price increases in the month of October and following it up with further increases in the month of November.

If we look at the EBITDA per KL post FOREX, for the quarter it declined to about Rs. 3,756, and this is compared to Rs. 5,125 from a year ago. Once again, there was some amount of impact due to the MTM FOREX losses, but the main reason was due to the aggressive pricing that happened in both the domestic and export segment.

Our Hamriyah plant also had a slow quarter on account of the low business volume that comes during and post the Ramadan period and a fairly difficult weather conditions in that territory. Having said that, we expect higher sales volume and especially much better profitability to come about both in the India manufacturing sites as well as from the Hamriyah site during the third and fourth quarter of FY18.

Just some more details on the auto lube segment, we delivered a volume of 8,196 KL for the quarter and this is the highest sales that we have had of auto lubes in a particular quarter. It has registered a growth of 30% compared to the same period previous year, despite a very slow month of July. So, August and September actually really outperformed in the case of the auto lubes segment also.

When you look at the six months FY18 for the Oils segment, the revenue for the segment has increased by 20% to reach Rs. 1,004 crores and once again it is really transformer oil, automotive oils and to some extent white oils which have resulted in the higher sales volume. Global shipments for the period increased again by 12% and we hit 191,928 KL. The EBITDA per KL, however, for the first half came in at only Rs. 3,915 per KL.

I would like to now move on to the cables business. The cables business has delivered a revenue growth of 20% in the quarter with revenue coming in at Rs. 241 crores compared to Rs. 201 crores from the previous year. This growth has actually come from the power cable side. The elastomeric cables has actually declined temporarily, mostly coming out of issues with respect to customers in the non-conventional energy sector. Our power cable and optical fiber cables grew by about 52% and 36% for the quarter respectively. In the case of optical fibers we actually received some orders from BBNL which we were able to timely execute in Q2. The EBITDA post FOREX adjustment actually came in at about 8.6%.

If you look at the half year for the cable business, the revenues are up 33% and have reached Rs. 495 crores. We are pretty much on target to actually hit Rs. 1,000 crores for the cable segment for this financial year. The post FOREX adjustment EBITDA was up 20 basis points and has come in at 8.3% compared to a year ago. Our power cable segment volumes have dramatically improved, margins continue to remain tight due to higher competitive intensity. So our focus now remains on actually increasing the scale of the business and reaping economies of scale, particularly in the power cable production.

The elastomeric business witnessed a lower demand during the quarter, as I mentioned earlier, largely due to the wind mill segment as well as a temporary decline from the solar segment due to not only the monsoon but also certain uncertainties which were there around the applicability of GST.

The OFC volume improved due to the orders from BBNL. Our new CCV plant which produces high voltage cables has been commissioned and is now running at over 50% capacity utilization. We expect it to almost run at full capacity by fourth quarter of this year as we are booking new orders against tenders.

So, having said that, we are already seeing some of the uncertainty around GST beginning to settle down, which along with improving DISCOM health should lead to higher orders in all our segments. There are a few aspects of GST, especially the whole website based posting, matching and refund mechanisms which are not working. Our expectation is that this will result in cash flow related issues, not only for what has happened in the past but also from some of our customers. Several well laid out processes which were there to handle exports, concessional duties and refunds, etc. in the pre-GST era which could have been continued in the GST era has been dismantled and the viable alternatives are still not fully in play.

Going forward, however, we expect that the second half of FY18 should be stronger for all the three segments. In the conductor segment we would have increased production coming out of Jharsuguda which is more competitively located today on the basis of production cost. In the oil segment we are expecting a fairly strong second half for transformer oil, especially in the 400 KV to 765 KV segment. In addition to this most of our major transformer customers have seen a significant increase in the amount of tenders for high voltage transformers being announced, and in some cases being awarded. So, this should bode very well for our demand in the year FY19 when execution of these new tenders will come.

Our cables business is well placed to grow with strong growth expected in the power, telecom and the railway segment. We have seen that there is almost a 40% increase in the order booking that we have had in six months this year for cables going to the railways compared to the last year. Our feeling is that as we move towards FY19 the cycle of cables being ordered by the railways will substantially increase. As many of you may know, the railways are targeting about Rs. 35,000 crores to be spent in railway electrification. The government is also aiming to double its telecom footprint and this is pushing ahead with the Bharat Net project rollout to connect about 2.5 lakh villages and panchayats through an optical fiber network. So, both of these initiatives actually are something that should do well for our cable business.

The Make in India for some of the defense related products is also picking up steam and we have commensurately seen increased order booking for ship building and defense at our end compared to what it was a year ago.

So, all and all we believe that the second half looks a lot better, probably the worst with respect to the impact of the GST is behind us. Though it will still take probably a three to four quarter for actually the full GST impact to completely settle down with respect to processes. But in short, we expect second half to be better than the first half.

So, with this I would like to actually end my comments. I would like to also thank all of you for joining our call. And we would be happy to throw open the floor to questions at this stage.

Moderator: Thank you very much, sir. Ladies and Gentlemen, we will now begin with the question-and-answer session. We have the first question from the line of Vikrant Kashyap from Kedia Securities. Please go ahead.

Vikrant Kashyap: Sir, as you mentioned that second half is likely to be better than H1, can you give some margin guidance, and will we see improvement in margin compared to second quarter or first half?

Kushal Desai: Yes, we will certainly see better margins compared to the second quarter. So, in terms of the guidance which we had given at the beginning of the year, in our oil business of about Rs. 4,680 KL. We feel reasonably confident that we will hit that guidance for the full year, even though the first half has actually come in at about just a little below Rs. 4,000. So, the oil side we see substantial price increase taking place, we have taken an MTM hit in the last few days of the last quarter which will get reversed in this quarter. As far as the cable business is concerned, we have given a guidance of 8.3%, we are bang on 8.3%. We may marginally exceed that in the second half if the shipments for some of the railways and defense actually happen the way we are expecting it to happen, given the new orders. The conductor side is where there will be some amount of pressure that we see. So, we had given an EBITDA guidance of about Rs. 10,500 per ton, so we are seeing that it may come about Rs. 1,000 lower at about Rs. 9,500 a ton given whatever we are seeing today. But if you add all this up, the second half will end up being better than the first half.

Vikrant Kashyap: Yes. Sir, in conductor even Rs. 9,500 per ton is better than what we have done in first half.

Kushal Desai: It is not better than what we have done in the first half, but it better than what happened in Q2.

Vikrant Kashyap: In HEC we have seen only 12% contribution, as said, their execution has been slower. So, do we see contribution from HEC going up in H2?

Chaitanya Desai: Actually, for some reasons some of these tenders, although they have come out, they have not been finalized which is normally not the case but it is just coincidently in several boards those tenders have not got finalized so far. So, it is difficult for us to confirm how things will be in H2. In the normal course we think those basic lines are to be reconducted, so definitely the demand exists, but for some reason the execution or the tendering process is taking longer. It is possible it may get bunched and we may get a little more work whenever those tenders get executed.

Vikrant Kashyap: Right. You also mentioned about Chinese price going up and is matching to LME prices, so do you see not in second half but going forward it giving us more edge in international market and we should see improvement in margins and order booking in international market?

Chaitanya Desai: For sure, yes, because earlier the Chinese Shanghai Metal Market was about $200 lower compared to LME and now it is more or less at the same price, in fact marginally higher. Normally in the past whenever there was no disparity between the two index prices, the Indian producers such as ourselves were in actually better position to get the international business because of the higher cost of production in China, other than the raw material part. However when such a significant difference or benefit that the Chinese had in the recent past, that is where we saw some drop in our international market share.

Moderator: Thank you. We have the next question from the line of Alok Deora from IIFL. Please go ahead.

Alok Deora: Sir, just had a couple of questions, one was on the conductor part, you mentioned that you have taken some orders by bidding aggressively. So, these orders have come primarily from which segments, like from Power Grid or from the local EPC players? And do you see this thing continuing in the third quarter as well?

Chaitanya Desai: So, the business has come pretty much across the board. Power Grid now is not playing such a big component of the business. It is also having major EPC component and the private sector business. Going forward, we do think that the conventional conductors there will be some competition in the market place for a while, but once the demand picks up in the domestic market then we think things would stabilize. Also with the GST system having being set, there is a marked difference in the cost of production if you produce in Jharsuguda compared to now production coming out of SIlvassa. So, you will see that as we are quoting on new tenders and stuff, the amount of order execution from Jharsuguda plant will start increasing. That will also help us to be relatively more competitive compared to some of the other players whose production capacity still remains more in the Silvassa and the Western India area. So, few of these dynamics are changing, there are quite a few moving parts at the moment. But if you take an overall look, Apar stands to be getting more competitive relative to competition, at least with respect to production cost. We are also at a very, very advance stage actually of signing a molten metal MoU which would give us further benefit. So the expectation is that may be in the fourth quarter of this year we could actually see something happening on that particular front.

Vikrant Kashyap: Alright. So we do not see any significant pressure on the margin because of the relatively low margin order book getting executed in the third and the fourth quarter?

Kushal Desai: So, we see some of that, which is the reason why we have taken down from the earlier guidance, the first half came in at Rs. 10,079. So there will be some impact partly because we had factored in a higher percentage of high efficiency conductor orders execution in the second half. This is clearly getting pushed back a bit until these tenders get finalized. So, sometimes the tendency is that they take longer to finalize and then they play more aggressive delivery schedule on that. But all this is something that one can be a bit clearer about once the orders are actually placed. The good news is that the tenders have to be finalized because there is a requirement for the government to debottleneck the lines. So, it is just a matter of time before which we see the execution happening.

Vikrant Kashyap: Right. Just one question on the OFC cables, you mentioned about optic fiber availability still being sort of an issue. So, off late has there been any change in terms of the availability and the pricing of fiber and how is that impacting the business there?

Kushal Desai: So, the fiber worldwide continues to be in extreme short supply at the moment. A lot of it as we spoke in the last quarter's call has been because of some phenomenal demand that has come out of China. Having said that, many global producers are actually reacting with more fiber capacity and our expectation is that as you move into FY19 some of this capacity is actually going to roll on and fiber availability will improve. The prices will continue to remain high for some period of time, our sense is that price of finished cables will then adjust accordingly because this is not only an India phenomena but it is happening across the world. So, the business is actually going to be driven not so much by fiber price as much as by the demands that actually come forward by BBNL for this whole village electrification. So, if that business comes on stream then the high fiber prices will get rolled into the prices that are there against the tenders.

Vikrant Kashyap: Right. Just one last question, so we maintain our volume guidance for conductor business or do we look at some change there?

Chaitanya Desai: We do anticipate some reduction. Earlier we were anticipating close to 160,000 tons, now it may be closer to 140,000 tons.

Vikrant Kashyap: Okay. And next year it should then normalize?

Chaitanya Desai: Yes.

Moderator: Thank you. We have the next question from the line of Saurabh Patwa from HDFC Mutual Fund. Please go ahead.

Saurabh Patwa: Just wanted to understand that the guidance which you give in the beginning of the year and like which you are maintaining now, I assume this would be before adjustment, right? You would not be able to predict the mark-to-market because of the FOREX?

V.C Diwadkar: The guidance is always given after adjustment of FOREX. What we are saying that net, net if we incur the FOREX loss it will be adjusted in the price and our EBITDA margin will remain what we had given as a guidance.

Saurabh Patwa: So, this guidance I assume, because this is basically the mark-to-market right?

V.C Diwadkar: What we are saying that if we incur any FOREX losses during open period then that will get adjusted in the pricing and that is why the EBITDA guidance remains same.

Kushal Desai: So, Saurabh, what will happen is that when you look at it over the four quarter period we should be able to deliver, there is a certain cost which comes from forward cover and a certain cost comes just because of the MTM. So considering both of those we expect that we will be able to deliver Rs. 9,500 a ton on conductor, about Rs. 4,700 per KL on oil and 8.3% on cables.

Saurabh Patwa: Secondly, sir, though we give the EBITDA per metric ton in conductors, I think from last two, three quarters we are not giving the exact quantity. Though we can back calculate it, but any specific reason for not giving that number?

V.C Diwadkar: No, there is no specific reason, you can easily calculate it.

Saurabh Patwa: I understand. So I have already calculated it, because historically we used to give, transformers we are already giving.

V.C Diwadkar: We will give from next quarter.

Saurabh Patwa: And sir just one thing, if I can ask one more question, in the previous quarters we have spoken about the HTLS conductors, the turnkey projects. Any specific thing which you would want to update on in this quarter, or is it that it remains the same as you had given in the last quarter?

Chaitanya Desai: So, the trend is definitely very positive, as more in India starting to consume this product. The only thing is for this quarter there were some delays in the tender finalization, and also as explained the GST has played a role in delaying a lot of the tenders and the execution and also in some cases the clients are asking for the discounts for the old contracts. So, that was disrupting the whole process for placement of orders. But, going forward we think things should improve in terms of quantum, not only in India but even some of the export markets which will be another avenue for us for the HTLS conductors or high efficiency conductors.

Kushal Desai: The other thing, Saurabh, I do not know whether your question alludes to this or not, but the system of execution is still remaining the same that all of this is actually coming in a form of turnkey reconducturing type of project. So, all the tenders are of that format and will continue to be in that format.

Saurabh Patwa: So, that is the reason we have to bid it in the format they are coming?

Kushal Desai: Yes. And in fact we have built up a good execution team on that front, so the format in which these orders are being executed today, we have actually stepped up to it. So we are quite comfortable with that whole system where you are given a line and you are given what you want to debottleneck on the line. So, the engineering solution is provided and then followed up with the execution of the reconducturing.

Saurabh Patwa: And can you share us the total capacities after both these CAPEX which we have done in both conductor and transformer

Chaitanya Desai: On the conductor side it is close to 180,000 tons.

V.C Diwadkar: And on the oil side it is 542,000 KL.

Saurabh Patwa: But sir, we had 180,000 tons last year also, so this new addition…

V.C Diwadkar: No, that 180,000 tons was after the starting of Jharsuguda plant. Right now what we are doing is we are just shifting the capacity from Silvassa to Jharsuguda, because Jharsuguda is more competitive.

Chaitanya Desai: The other CAPEX which is being employed at Jharsuguda besides the shifting of the machineries from Silvassa to Jharsuguda is that we are in the process of setting up this new rolling mill which would receive molten metal. That will also improve the economics once the molten metal project starts running.

Saurabh Patwa: Right, sir. I think you have explained in the previous quarter as well?

Chaitanya Desai: Yes, exactly. So, the execution of that will happen, probably we will see the execution of it and benefits coming in from Q4 onwards when this plant will come on-stream.

Moderator: Thank you. We have the next question from the line of Divyata Dalal from Systematix Shares and Stocks. Please go ahead.

Divyata Dalal: Sir, my question pertains to the oil business. In the presentation we have mentioned that there has been increase in demand projection, mainly for 400 KV to 765 KV, and that is expected in H2. So, will this be in the domestic market or for the export market?

Kushal Desai: No, this is all in the domestic market. I mentioned two different things, one is that for existing orders which have been placed we have been given indications that the oil will be required in the second half of this year. So, these are tenders and orders already finalized sitting with the large transformer companies. Their execution is going to happen in Q3 and Q4 and we have been given some tentative schedules for delivery. So, given that we expect a higher volume to happen in the second quarter of these oils. The second thing I mentioned is that besides this a whole lot of new tenders for extra high voltage and ultra-high voltage have come up for bidding. These are extremely large tenders and it will dramatically improve the capacity utilization of the transformer industry. So, we see a very positive picture for the oils going into high voltage transformers coming up in the following year, given the typical execution cycle that is there.

Divyata Dalal: This impact for the new tenders could come sometime in FY19 in terms of orders?

Kushal Desai: Yes.

Divyata Dalal: And this H2 whatever we are seeing is from the existing orders which are being placed?

Kushal Desai: Which are already been placed on transformer companies and their execution is going to happen. So, in short, you will see transformer oil volumes going up for this segment from Q3, Q4 of this year all the way through FY19.

Divyata Dalal: Okay, in terms of other segments of oil like auto oil and industrial oil, how is the demand traction there? Auto oil we have done very good growth in this particular quarter, so will that traction continue?

Kushal Desai: So, we are expecting that Q3 and Q4, if you look at the full year performance on automotive oil this year versus the previous year, we should see at least close to 20% to 25% growth year-on-year on volume basis. One of the things that has happened is that GST has benefitted the lubricant side of the business, so the net or the total taxes being paid on lubricants is actually lower than what it was earlier. With the GST coming in, organized retailing is also receiving some sort of a fill up. So, we have seen relatively good demand and we continue to see that demand at least in Q3 and Q4.

Divyata Dalal: And on the geographies size this will be still restricted to southern side

Kushal Desai: No, so we have seen growth happening not only in the south but also in the west and in the north. Our distribution is not that strong in the eastern part of the country and we have not focused on that either. But it is a broad based growth happening pretty much across these geographies.

Divyata Dalal: Okay. Sir, given the improved outlook in both auto and transformer oil, any guidance uptick that we will do for volume growth or we will maintain a 10% to 12% volume growth for the full year in the transformer oil business?

Kushal Desai: We have done reasonably well in terms of volume, our focus in the second half is going to be to deliver a good volume but more on actually recovery of margins. Because we are running around Rs. 700 per KL lower on an EBITDA per KL basis for the first half. So, we need to catch up on margins through the remaining six months, and we feel reasonably comfortable on that. So the focus is going to be more on actually delivering margins then just volume in the second half. Base oil situation has also become much tighter in the second half compared to the first half. So that actually enables us also to have slightly better pricing power in the market to push through the price increases. So, we feel reasonably confident that we will hit that number in the second half.

Divyata Dalal: Okay. Base oil supply you said has become tighter, is it?

Kushal Desai: Yes.

Divyata Dalal: Okay, so that will help us to put in higher price?

Kushal Desai: What happens is it always helps companies which actually have long-term purchase contracts because then the spot availability reduces and the prices on the spot market actually go up, because they are just purely dependent on supply and demand. So, for a company like us which is more organized in terms of our supply chain, it always helps in terms of a tighter availability situation. It also allows us then to focus and get the better pricing on our value added products. So, those two effects put together we expect to be able to catch up on the margins.

Moderator: Thank you. We have the next question from the line of Sandeep Baid from Quest Investments. Please go ahead.

Sandeep Baid: Kushal, a couple of questions on conductor first. The shifting of machinery to Orissa, we are through with that now?

Chaitanya Desai: We will be through by the end of this quarter. Basically it is in progress right now and much of it is done.

Sandeep Baid: Okay. Second, you mentioned that the railway electrification is a big opportunity and you talked more about cables at that time. But will it also help our conductor business?

Chaitanya Desai: Yes, because some of the work is now given to Power Grid also. And some of the EPC contractors are quite comfortable buying from Apar, so we may be favorably placed to do that business.

Kushal Desai: It will definitely, open up the addressable market as well for conductors.

Sandeep Baid: Okay. So, we can see much higher volumes in FY19 on the conductor side?

Kushal Desai: We should see definitely some impact of that coming in, plus there are copper conductors which go into this electrification and we have got ourselves now in a position to be able to get after the copper conductor market also which is like a relatively new opportunity that may come up as this railway electrification plan goes through.

Sandeep Baid: Right. And lastly, the MTM losses which I understand was both on conductors and oil, was that around Rs. 7 crores to Rs. 8 crores in Q2?

V.C Diwadkar: No, MTM loss in conductor was around Rs. 2 crores and in oil it was around Rs. 3 crores.

Sandeep Baid: And do we see this reversing in Q3?

V.C Diwadkar: It will reverse actually, it already reversed. Today dollar Rupee rate is at 64 something and we closed the September at 65.40.

Kushal Desai: In addition to that, actually we have also been able to reprice product in October and in November, so that takes into account the foreign exchange and the base oil and all this. So, the conductor side is just the pure timing issue. In the case of oil it requires you to also then go in the next quarter with a higher price and that has also gone through.

Sandeep Baid: Okay. And coming to the cables business, you mentioned that power cables has been extremely well but electrometric cable because of the issues on wind and to some extent on the solar side, that business has been slow. So, just wanted to understand your outlook on this business for the next 6 to 12 months? And secondly, I assume that there are certain processes for making elastomeric cables common with power cables, so how fungible are the manufacturing facilities for these two products?

Kushal Desai: So, actually there is relatively low fungibility between the power cable and the elastomeric cable. The conductor manufacturing portion is common, the elastomeric is largely copper, whereas the power cable is almost today entirely aluminum. So, the fungibility is not really very high. These are like two plants with parallel processes that run. Specifically on wind and solar, the wind industry I think is going through a very though time, because the solar tariffs have fallen so much below the wind tariffs. However, the government is talking about announcing various tenders for wind specifically, given I guess a wind corridors is where they expect this power to come up from. Our sense is that the solar demand will definitely pickup; A) it remains a bit slow in terms of execution during the monsoon period because it is all done in the open; and B) the Government has done an A-class job of confusing everybody on the tariffs with respect to solar project. Because, I mean, at face value it should be that cables gone into the power generating part of the system should be at 5%, whereas the normal tariff is at 28%. The advisory that all the cable companies have received after interacting with the government is that we should be charging 28%, which actually does not really fit into the scheme of what the government seems to have announced. So, clearly the CAPEX cost of some of these guys has gone up, and there is a lot of lobbying going on to get things clarified there. So, my expectation is that now this is the season that is coming up for execution of these outdoor projects, so it should start substantially picking up.

Sandeep Baid: Right. And I assume that there will be fungibility between your railway and the defense cables and the solar and wind Cables? So, if demand for those products go up you can partly utilize a capacity for that.

Kushal Desai: Absolutely. And actually the number of contracts and tenders and all that which have already been awarded on the solar side is huge. So, it is like 50% more this year than in the previous year, so you know when this comes up for execution and it will, the only reason why it has been tied up is because of some of the lack of clarity on this front. So, our sense is that the execution on the solar side will also pick up. The Wind is a bit of the question mark until some of the specific wind based tenders come up. And we are seeing that the order books which Gamesa and Inox have is also they are having operating difficulties right now. Even Suzlon has actually scaled down some of their requirements of cables. But we feel that it should be offset with the railways, defense and the solar side.

Sandeep Baid: Right. And lastly, with GST there, are we already seeing some benefit of no CST now on the oil and the cable or you are still to see that benefit?

Kushal Desai: No, immediately with the GST implementation the disadvantage that we had on account of 2% CST relative to competition, that has disappeared. Our Rabale production facility is actually today having the best location because it is so close to the Mumbai Port, the JNPT and the Mumbai Port. So, the incoming logistics is low and then if you are shipping product in Maharashtra and South, it is the best location to be in. So we were paying actually a 2% local body tax, this has also got abolished with the onset of the GST. So, the benefits of that are actually starting to come in. So from a relatively competition standpoint, I think we are better off from an operating cost standalone.

Sandeep Baid: Right. So these benefits, I assume that because of the inventory of the competitors these benefits would not have been there or would have been less in Q2 and that it will become more apparent Q3 and Q4.

V.C Diwadkar: It is true actually.

Kushal Desai: Yes, absolutely.

V.C Diwadkar: The old inventory will be having all this.

Moderator: Thank you. We take the next question from the line of Varun Agrawal from BOI Axa Mutual Fund. Please go ahead.

Varun Agrawal: A couple of questions, can you revise the guidance on the conductor side? Just trying to check are we reversing downwards in terms of volumes also?

Chaitanya Desai: Yes, we are expecting reduction in volume also this year, because in the Q2 we saw a lot of business getting deferred. Part of it as, I explained, was on account of some of the clients asking for rebate, revised pricing, and also manufacturing clearances for some of our EPC clients got deferred, because they in turn were facing the same issue with the end client utilities.

Varun Agrawal: Okay. So, 140,000 is what we gave the volume number, right?

Chaitanya Desai: Yes, this is what we anticipate now.

Varun Agrawal: But if we look forward to FY19, so on demand side we do not see an issue, right? So, basically this is due to some of our operational constraint and GST implementation of the end user.

Chaitanya Desai: Exactly, yes.

Varun Agrawal: Sir, second question is in terms of the way the contracts are being bid now. Do you see margins coming down due to the bidding patterns the way we have to bid now or do you think there is a room for us to maintain our margins?

Kushal Desai: So, I think it will be all subject to the demand, actually. If the demand is soft then definitely people will be a little more aggressive on pricing, like we have been seeing off late. But as we anticipate that the demand should come back to normal. Therefore, I do not think that there will be such aggressive pricing going forward. The other factor we discussed about the Chinese who had the advantage which was forcing us to compete internationally on aggressive basis with them, there also now things may be a little bit better. And last point is that on the risk management front in the past couple of years ago there used to be more of the variable type pricing and now there is a fixed pricing because of the tariff, competitive bidding type work. So we have been quite prudent in our risk management compared to some of our competitors. So, it is possible that some of the aggressive pricing that the competition was doing and now the LME having gone up there may be some hit also on account of that. While we have been a little more risk averse compared to them.

Varun Agrawal: So when you said in domestic business also the fixed pricing has, I mean, the way that you are bidding earlier use to be variable pricing, if I am not wrong?

Chaitanya Desai: Yes. But for the conductor manufacturers it is still primarily on variable pricing because the risk was being picked up by the EPC companies.

Varun Agrawal: Right. So now going forward there will be fixed pricing, you are saying, right?

Chaitanya Desai: The EPC parties will still have the fixed price and of course, there is effort by the EPC contractors to pass on that risk to the conductor companies, which we have been in some sense resisting. But may be the competition in our case had relented and given that firm price where now they will probably suffer.

Moderator: Thank you. We take the next question from the line of Maulik Patel from Equirus Securities. Please go ahead.

Maulik Patel: Sir, one question is that, a lot has been discussed within the auto lubricant segment that a large unorganized industry is there, and post GST they will struggle to grow and organized industry will take a market share from the unorganized. Do you see that happen over the next couple of years?

Kushal Desai: It will absolutely happen, Maulik because what is happening with the unorganized sector is that they were playing around with the payment of VAT, octroi, all these sort of things. And now when it comes into a single integrated tax then obviously any form of evasion of that does not count. Also, if you see before, if you added up all the taxes it was coming to around 27% - 28%, depending on the state, and the taxes have been brought down to 18% today. So the whole chain will become now just completely organized retail. We were anticipating before GST implementation that we may find more issues on the consumer side with all the traders and retailers resisting themselves and things like that, and we would relatively find it easier with in the B2B or the B2G segment with the governments. But actually what has turned out has been exactly the reverse. The consumer side has picked up fairly strongly. And we have seen relatively very low hick-up so far in that, other than the fact that this invoice matching and all that is still not happening. But otherwise the physical off-take has been quite good on the B2C side. It has actually been that wherever the government has been involved there has been the maximum problems because of them wanting to renegotiate purchase contracts, wanting benefit of GST to be passed on and things like that. Some of the departments have not even got themselves registered for GST. So, material manufactured, inspected but could not be dispatched. So, I think the government side has actually taken the longest time to get themselves organized, which we believe now is already falling in place, so we should see something more beneficial happening now in the second half.

Maulik Patel: Okay. And so the first half we have seen the entire oils segment close to around 12% to 13% volume growth is there. And you mentioned that second half focus is more on margin that is on the growth side because we have already done the best first half we have in many years.

Kushal Desai: Yes. So what we plan to do is that we plan to focus on our margins and allows a volume to be the plug number. In one system you look at saying, "okay I want to sell this much volume and what is the best price I can get for it." But I think in the second half we will focus more on our mix and the profitability. If the volume actually gets a bit truncated then so be it, but we will focus more on ensuring our profitability is higher. As I mentioned earlier, the mix for our transformer oil should be very favorable in the second half. And the automotive side has also shown good growth. It is the white oil side which been relatively commoditized and we plan to take the view in the second half that if we do not get the right pricing we will just allow that volume to fall away.

Maulik Patel: Great. Sir, last question, this quarter our interest cost has gone up, is this something related to the tight working capital post GST implementation?

V.C Diwadkar: There are two things actually, one is that you will see that the open period FOREX has gone up by close to Rs 8 crores. That is one impact. So open period FOREX we are considering in the EBITDA margin actually. So you should not look at it as an interest cost. And second thing is that it is true that because of the working capital issues, the GST issues, a lot of funds have got stuck up in the business.

Maulik Patel: But that should be released over the next six months or nine months?

V.C Diwadkar: Yes, definitely.

Kushal Desai: The issue that is there is the government has exempted now payment of IGST on advance license from 6th of October, but there is a complete mess in terms of handling it from 1st of July to 6th of October, because that website of theirs is completely broken and it is not working at all. So it does not have the names of the people who have actually cleared the goods or claimed refund, etc. And it seems like from whatever our talks have been with the department that it is going to take a few months. So the good thing is that there is no more further blockage of funds taking place, but whatever is blocked is likely to take much longer than we thought it would take, the government is saying that the refunds would have started from 8th of October onwards, there is nothing such thing happening.

V.C Diwadkar: Nothing is in place, actually.

Kushal Desai: The entire JNPT list of refunds is coming to only Rs. 48 crores as of yesterday, whereas there must be at least Rs. 15,000 crores worth of goods cleared under duty free basis from that port. So, I think that is going to take some time. So there will be an interest cost that you will see in our books getting picked up because the capital stuck will be a bit higher. Hopefully in the next few months the government will sort out the GST and network related issues and this refund process will start.

V.C Diwadkar: Another six months this issue may be there actually, after that we hope that things will get stabilized.

Maulik Patel: Okay. And sir, earlier we mentioned about the CAPEX for this financial year is approximately around Rs. 100 crores, you are sticking to that number, right, no changes to that?

V.C Diwadkar: We are sticking to that number.

Moderator: Thank you. We have the next question from the line of Mehul Mehta from Sharekhan. Please go ahead.

Mehul Mehta: This is with reference to working capital, you are saying that like it is stretched, but if one looks at like an overall working capital it seem quite stable. So, where would this amount, like, Rs. 68 crores would be sitting?

V.C Diwadkar: If you see the balance sheet it is there in the other current assets.

Mehul Mehta: That is where you are finding whatever is stuck in the system?

V.C Diwadkar: Yes.

Kushal Desai: So, in the short-term what has happened is that Rs. 68 crores is stuck on account of the IGST refund. And this cable GST being at 28% you end up having to actually pay additional GST over and above input credit, which then goes into the collection cycle. So if the collection cycle is 90 days then again more money is stuck until your client pays you. So, all put together has resulted in about a little over Rs. 100 crores of working capital getting tied up.

V.C Diwadkar: For exports, to merchant exporters also we had to pay IGST earlier before 6th October, after 6th October they have reduced that and they are saying it is now 0.1%, earlier it was 18%. But that amount will sit in debtors actually, this cable amount and that merchant exporter amount, that will sit in debtors.

Mehul Mehta: Alright. Another question in terms of transformer oil, when you are sharing buoyant outlook for second half and like even year ahead, are we gaining some market share or it is across like.

Kushal Desai: The market share that we have in that segment is already pretty high, we are already at over 60% in the power transformer side and especially for this 400 KV to 765 KV. So, even if we stick to the current market share that we have, just the total volume of business going into that segment will start picking up. And you will start seeing, if you track order booking of transformer manufacturers, you will see a sharp improvement happening in the second half of this year. So that will reflect in terms of automatically oil demand picking up in the year after.

Mehul Mehta: Alright. So, in terms of say like capacity utilization, so for transformer manufacturers I am saying, so would this result into better pricing sort of when you were not having good orders and situation improving should that result into some sort of margin improvement?

Kushal Desai: So, for us the way we look at it is that if the transformer manufacturer's order books improve and if their pricing improve, etc, then given the benefit of the better utilization and profitability we see the biggest impact happening on our cash flow. If you have seen in the last few years the transformer oil collections have been slipping, we have managed to maintain it as the oil business as a whole because as an automotive business and industrial business has been growing that has a shorter collection cycle. So, the two order kind of contrast each other out, but still cash has been stuck more in the transformer oil cycle. So, we see actually cash flow being the biggest beneficiary, once the health of these transformer companies improving. And that seems now pretty much eminent, and these are really big tenders, so I think it will help the transformer manufacturers and the collateral benefit will come automatically to us.

Mehul Mehta: Okay. So, on a broader sense can you share sort of capacity utilization whatever you may be seeing for a transformer manufacturer, overall industry size kind of how is it improving?

Kushal Desai: So, I would not be able to give you very specific numbers but some of the larger manufacturers would see anywhere between 15%, 20%, 25% growth from their low period. In many cases some of the better manufacturers still had a reasonably good order book, but the profitability of those orders was very low. So, now with a strong flow of tenders coming in I am sure they will price the transformers at better levels.

Mehul Mehta: The pricing power improves kind of?

Kushal Desai: It will definitely improve.

Moderator: Thank you. As there are no further questions from the participants, I would now like to hand the conference over to Ms. Nisha Kakran for closing comments.

Nisha Kakran: I would like to thank the management for giving us this opportunity to organize the call and all the participants to join in. We look forward to connect with you on the next call. Thank you, everyone.

Moderator: Thank you very much. Ladies and Gentlemen, on behalf of Four-S Services, that concludes this conference call. Thank you for joining us. You may now disconnect your lines.