APL Apollo Tubes Limited

Q2 and H1 FY2017 Results Conference Call
November 03, 2016

Moderator Ladies and Gentlemen, Good Day and Welcome to APL Apollo Tubes Limited'sEarnings Conference Call. As a reminder, all participant lines will be in a listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Anoop Poojari of CDR India. Thank you and over to you, sir.

Anoop Poojari Good morning, everyone, and thank you for joining us on APL Apollo Tube Limited's Q2 and H1 FY2017 Results Conference Call.We have with us Mr. Ashok Gupta – Managing Director of the Company, Mr. Sharad Mahendra – Director Sales & Marketing and Mr. Deepak Goyal – CFO of the Company.

We will initiate the call with brief opening remarks from the management, following which we will have the forum open for an interactive question-and-answer session. Before we begin, I would like to point that some statements made in this call maybe forward-looking statements and a disclaimer to this effect has been included in the conference call invite emailed to you earlier.

I would now like to invite Mr. Ashok Gupta to make his opening remarks.

Ashok Gupta Thank you. Good morning, my friends. Wishing you all a very Happy Diwali. Q2 FY17 was quite a rewarding quarter for us, even though it was quite challenging as well. We were able to improve our EBITDA to around Rs. 3,500 per ton, which is better than Q2 FY16. And this is, despite, the difficulty which has been going on in the country for past few quarters.

We were lucky, the country was lucky that we had a good monsoon this year. And as you all know, good monsoon means goodfor the country, good for the farmers.What is good for the farmers is good for the pipe industry, and obviously good for us, even though there could be some short-term pains. During the season of monsoon, the demand, particularly from irrigation and from construction may go down, but after a subsequent period, particularly the period of harvesting and period of sowing, i.e. November and December, and again from February to April, the demand for agricultural sector picks up and also for the construction industry. Demand, particularly from rural sector will increase significantly because of the good monsoon. So, while it has some effect on us during the quarter, subsequently it will be good for the pipe industry as a whole.

We are all aware that Southern region accounts for over 40% of our sales. It is a very important region for us. Unfortunately, for some period, there were disturbances because of some water disputes thathad a significant impact on us.As you know,both our units are on the border of Karnataka and Tamil Nadu where the impact was maximum. So we faced significant slowdown of production andtransportation. There was hardly any movement of vehicles for around 15 days. So this has affected our sales in the Southern region, particularly in this quarter. Overall, we try to achieve a growth of around 20% year-on-year for every quarter. However, this quarter we were only able to achieve 11% because of these factors, other than that the general economic scenario was also not all that bright.

Despite these kind of problems, we have achieved growth and our EBITDA margins are also better. And friends, coming days lookeven brighter. We have been talking for quite some time about a new technology that we are bringing in the country that is Direct Forming. By this technology we will be able to form squares and rectangles directly from the strip without going to the intermediate stage of rounds. This is a significant breakthrough in terms of technology globally. Even now, very few countries have got this technology and are able to make squares and rectangles directly. We will be the first one to get this to India and we are getting it in a big way. I am happy to share with you that our first line maybe starting this month end or maybe by next month. So this, we are expecting will give us significant advantages. A lot of people, particularly the equipment manufacturers who are not able to find a right kind of square and rectangle today will be able to get it from us after this technology is introduced, because this technology enables us to produce unlimited sizes. And not only in terms of size range, but also in terms of shape. The product from this will be of a perfect shape, a perfect rectangle or a perfect square, there will be no bulges. And more than bulges, there will be no round corners, corners will be sharp. More than that, it will be economical also because people will get longer length per ton of material. Apart from that, we will be entering into a higher thickness range and higher size range. Till now, we used to make square and rectangles with about 6 millimeter thickness, now we will be able to go up to 12 millimeter. Similarly, in terms of size also we will be able to increase from around 200 millimeter on one side to about 300 millimeter. So a lot of imports, which are taking place today for square and rectangle, thatshould stop.

Apart from this, we all are aware that we are going to start a new plant in Raipur. That plant is also likely to be operational perhaps byQ4FY17, which will add a significant capacity. It will start with one mill.Going forward by next year, it will have a capacity of around 3.25 lakhs per annum. This will be our first entry into the Eastern region.Eastern region is a market where we were not presenttill now. So, it opens a big demand for us in the whole region geographically and this should give us additional sales.

Going forward, we also expect additional sales from exports. As you know, the economies of Europe and USA are improving day by day, so a lot of enquiries have started flowing in from these developed countries. So we expect our exports, which are around 4% to 5% till now to increase significantly in the days to come. Similarly, as I said,the Direct Forming technology will enable us to enter in a big way in the OEM sector, the equipment manufacturing sector. So the people who make cranes, people who make vehicles, automobiles, they all will be able to use square sections using this technology including trucks and trailers. So we expect our OEM sales also to increase significantly.

Apart from that, we are also focusing on certain new segments -the solar power plants, they make all the mountings, they use square sections and there again we will be able to supply that desired section size which people are not able to get today. We are also entering fire fighting and air conditioning sector in the days to come, as a mean of diversifying our marketing portfolio. Apart from this, we are also looking at increasing our share of value added products which is GI-GP.

Currently GI-GP accounts for only 30% of our basket. Going forward, we hope to make it 35%, this should improve our margins.

With these kinds of initiatives, we expect the second half of the year to be better than the first half.Against a growth of around 12% - 13% in H1 FY17, we expect H2 FY17 growth to be around 18% to 20%. In the longer term, we will be focusing on strengthening our mark in the market. We are undertaking a massive branding exercise whereby it will be on the same line as we have done for many B2B industry. So each and every person will have trust and faith in our brand. We have appointed a consultant, Normex and they are experts in creating brand value. So hopefully in the next couple of months you will see a lot of buzz around the APL Apollo brand. And this should give us good returns in the long run.

Our focus on technology continues. We have just finalized a deal for a new technology in galvanizing, which is called Inline Galvanizing. That means, you do the zinc coating while a round pipe is being produced. So what will happen is that we do not have to have a separate galvanizing line, it will be in the same main production line itself. This has got significant economic advantages, apart from any product. Such a product till now has not been made in India, it was being made mostly in USA and Japan and some parts in Europe. But now it will come to India and we expect a big market for this.

So, with these few initiatives we think that not only in the short run in H2 FY17 but as well as in the long run we will be able to secure a better market and hopefully improve our market share as well. So, these initiatives will continue and I can assure you that the growth path which we have been taking for last 8-10 years which has been continuing, will continue in the future as well. We have been targeting a 20% growth in the previous year and we hope to do the same in the future as well.

I will also take this opportunity to introduce my colleague, Mr. Sharad Mahendra, who has just joined us. He is a Director of Sales & Marketing. He is an engineer, byqualification anda marketing man by profession and a proven leader in the industry. So, please join me in welcoming him to our portfolio. And with this, I would like to invite my colleague Deepak, who is our CFO, to give you some financials.

Deepak Goyal

Thank you, sir. Good morning, everyone. And thanks for joining us today. Trust all of you have been through the results document which covers our financial highlights in detail. I will now briefly discuss about the financial and operational performance for Q2 and H1 FY17.

In Q2 FY17,our total sales stood at Rs. 956 crore against Rs. 1,088 crore in Q2 FY16. In H1 FY17, total income stood at Rs. 2,083 crore as compared to Rs. 2,089 crore. Mr. Gupta has already covered the factorswhich impacted our revenue growth such as decline in construction and infrastructure activity due to the good monsoon seasons and Kaveri unrestwhich impacted our sales volumes. In spite of which our sales volume excluding Coil & Scrap improved by 11% to 2.36 lakh tons in Q2 FY17. In H1 FY17, sales volume growth improved by 11% also to 4.75 lakh tons. The Kaveri dispute adversely affected our sales volume by around 10,000 tons to 12,000 tons, which is around 4% to 5% of the Q2 volumes.

With regards to our profitability, Q2 FY17 EBITDA improved by 18% year-on-year to Rs. 84 crore. Total EBITDA margins stood healthy at 8.8% in Q2 FY17 compared to 6.5% in Q2 FY16. H1 FY17 EBITDA improved by 36% year-on-year to Rs. 176 crore. Overall EBITDA margins during H1 FY17 were at 8.4% compared to 6.2% in the corresponding period last year. Manufacturing EBITDA is at more than Rs. 3,400 per ton. During the quarter, depreciation stood at Rs. 17 crore and

Rs. 27 crore in H1 FY17. The increase was primarily due to the fresh capitalization in H1.

During the period, we established a new GP line in our subsidiary company Lloyds Line Pipes with a capacity of 40,000 tons. We have commissioned one new line of production in Hosur and also undertook various steps towards enhanced efficiency at the various plants. And according to the recent opportunity given by the Companies Law, whereby afaster depreciation is allowed on the components, we have used it on certain components like rolls, figure of Rs. 4.8 crore for both the quarters.

Furthermore, in consultation with our statutory auditorsand technical experts, the company had done physical verification of fixed assets on a half yearly basis which also leads to higher depreciation. Interest cost came lower by 4% year-on-year basis to Rs. 60 crore on back of lower inventory level and long-term loans. Long-term debts was lower at Rs. 539 crore from Rs. 599 crore as on March 2016. And I am happy to share that as on Sep 30, 2016, our net debt equity ratio stood at 0.86 as compared to 1.10 at March 2016.

The company also marked a significant improvement onthe inventory level, which stood at Rs. 408 crore as on 30th September, 2016. PBT during Q2 FY17 stood at Rs. 51 crore, registering an increase of 68% year-on-year, though I would like to state that the corresponding quarter last year carried exceptional item of Rs. 16 crore which was on account of the brand image expenses and anti-tax duty was being written off. In Q2 FY17, PAT improved by 68% to Rs. 34 crore, translating into EPS of Rs. 14.35. In H1 FY17, PAT stood at Rs. 75 crore, leading to an EPS of Rs. 32.02. In line with our margin focused approach, PAT margins during the quarter improved by 168 bps to 0.35% whereas PAT margins during H1FY17 improved to 3.6%.

To conclude, with ramp upin utilization levels and additional capacities coming on stream by end of this fiscal, we remain confident of delivering robust volume growth going forward. We have always focused on innovation and employing latest technology which we believe will ensure that we keep improving our EBITDA per ton which emphasizes on augmenting our return ratio.

Now, I will hand over to Mr. Sharad Mahendra.

Sharad Mahendra Good morning, everyone. Just to give you a brief in continuation to what Mr. Ashok Gupta in the opening remarks has commented about our growth in the first half of the year, which is close to about 11% to 12%. We just wanted to highlight the opportunities which we clearly see in view of all the new technologies of Direct Forming and other things of Inline Galvanizing and others which are going to be there in due course of time. At the same time, what we see as the underlying opportunities in near term is that if we see our total sales breakup, our sales breakup through the dealer and distributor network in H1 has been close to about 92%. And exports is close to about 6% and our sales to OEMs is close to about 1.5% to 2% only. And when we see this 92%, which is a large chunk and we definitely need to maintain the margins and the volumes, this has been primarily only in North, West and Southern part of country being strategic reason because of our plant locations. But now with our plant in Chhattisgarh also starting very soon, we will be entering into a new market through the distribution channel in Eastern market also which we expect will give us a reasonable incremental volumes from present levels which are almost negligible. So this is one opportunity which we see going forward in next few months will be available for us to be more competitive and entering a new market wherein our presence has not been there historically.

Secondly, in the OEM markets certain segments which have been identified which are large consumers of our product range what we offer have been identified, and normally OEMs take certain time in terms of approval process, submission of samples and all, the process of which has already started. And one of the biggest chunk is the bus body building which is happening across the country is one focus area. In addition to that, the big projects with this Direct Forming line, what Mr. Ashok Gupta also said that maybe we can go up to larger sections up to 12 mm thickness, so big projects which goes to maybe big companies like whether it is L&T or other major companies who are majorly importing these materials. So we expect these as the opportunities and with this kind of quality product wherein we will be the first to start in the country, international market, especially Europe and US and apart from that Middle East with a special focus on Dubai keeping in mind Expo 2020 the investment which is likely to be there between 2017 to 2019. So these are certain identified opportunities on which from marketing side there is going to be an absolutely clear focus approach and we have already started our discussions and approval processes for these things.

So this was just the brief, which I wanted to give about the opportunities going forward in near-term and long-term. Thank you.

Moderator We have the first question from the line of Nisarg Vakharia from Lucky Investment Managers. Please go ahead.

Nisrag Vakharia Could you elaborate a little bit more on the initiatives that you want to spear head the company with? Secondly, the OEM opportunities that we are discussing, how large can they get and what sort of EBITDA per ton or conversion margins or EBITDA margins do we look at in those opportunities?

Sharad Mahendra The OEM sector till now has been using substitutes to square and rectangles because the right size was not available. So, there is a big market for this. For example in the automobile sector, the replacement from the substitutes to square and rectangles will be steadily taking place.As you know, automobile people have a system of approvals, testing and all that. So we hope that in due course of time, our sales which are around 1% to 1.5% which is around 2,000 tons per month to OEM should increase to at least 10% to 15% in next maybe 1- 1.5 years. It should go up to around 10,000 tons to 15,000 tons per month in the coming 1- 1.5 years after the approvals and all that come.

Nisrag Vakharia Will the EBITDA per ton in that business be similar to company level or will it be higher?

Ashok Gupta Currently, we have EBITDA of around Rs. 3,500 per ton. These material have economical advantage and in addition, they will be substitute to whatever they are using today and which are more expensive. So, in the long run we expect EBITDA from OEM sector to be at least 2% to 3% more, even up to 5% more for these Direct Forming line materials. So EBITDA will start with increase of around 2% to 3% and going along it will be 5%, more than the current EBITDA levels.

Nisrag Vakharia Are there any large export opportunities that we can pursue with this technology?

Ashok Gupta USA is still following inch sizes and we in India are following the metric system. So we normally supply 150 mm x 150mm, whereas USA will go for 6 inches. 6 inches when you transform into mm it becomes like 151 mm or 152 mm. Our current method of productions do not enable us to produce 151 mm or 152 mm. The complete market of USA for hollow sections for square and rectangle was not being serviced by us because of the kind of equipment we had. With this Direct Forming, it will be possible to produce any size, whether it is 150 mm or 151 mm or

152 mm. So the entire USA market opens up to us, and USA is a big market, it is about 4 million tons per annum for square and rectangle only. So it is a big market, we will take a small pie. Let me tell you that the whole process will take time, we will have to send some trial and shipments in the beginning. Once they are accepted then we will start increasing the tonnages. But it may take us six months to eight months, but once we establish ourselves there, this will be a huge opportunity.

Nisrag Vakharia Will the EBITDA per ton in that business be much higher?

Ashok Gupta As you know, USA has anti-dumping against many countries, including China for many of the products, particularly steel. So prices in USA on an average are higher than in other parts of the world. So we expect USA to give us better margins. But I cannot say anything today, unless and until we try the market.

Nisrag Vakharia Is there an anti-dumping law against Indian products?

Ashok Gupta Not at this moment. It is only against galvanized pipes. Against galvanized pipes, there is 7% anti-dumping duty against India, but there is none at the moment against squares and rectangles, which we are talking about.

Moderator We have the next question from the line of Pawan Kumar from Unify Capital. Please go ahead.

Pawan Kumar I wanted to understand about the EBITDA per ton margins in Q2 FY17. From your commentary, it is around Rs. 3,500 per metric ton. What is the visibility that we can sustainthe EBITDA per ton, going forward. Last quarter, from your commentary we understood around Rs. 3,300 was sustainable. So what are the reasons for this particular increase in EBITDA per ton margins as of now?

Ashok Gupta In the case of steel pipe, price increase and decrease is a pass through. But for the fact that it could be lead or lag, that means if the prices go up or prices go down, the price of steel pipe will also go up and go down but there could be a gap of 7-10 or 15 days. So there could be minor elevation in EBITDA levels. Having said that, market conditions also play a part. If the market is subdued, EBITDA levels will tend to come down slightly. When market is more bullish, they will slightly go up. However, in the last couple of years they have been hovering around Rs. 3,500 or slightly lower than that, maybe Rs. 3,300, but we have been trying to inch them up. How do we do that is through these two things, A) we try to increase our share of GI and GP. Now GI and GP are galvanized products which give us better margins and in GI and GP, we are increasing from 30% to 35%. And the second part is, within square and rectangles we try to work out on very higher sizes. Typically market produces medium range, which is around 100 x 100 or 40 x 40, but we tend to go for higher sizes, 150 x 150, 200 x 200, and now we are going for 300 x 300. Because there are not many manufacturers for these sizes, you get a better premium. And thus our average improves. Going forward, we are hoping that our EBITDA will improve from Rs. 3,500 to slightly higher levels, inch by inch.

Pawan Kumar So is Rs. 3,500 sustainable?

Ashok Gupta It is sustainable, not only sustainable but we will try to improve upon it, it may be a marginal improvement.

Pawan Kumar You talked about the increase in proportion of GI and GP pipes, but however if you look at the volume data in Q2 FY17, the growth does not seem to have been much as compared to the black pipes. So Q2 FY17 EBITDA margins would be primarily due to higher sizes of square and rectangular pipes?

Ashok Gupta GI pipe is typically used for water transportation, particularly irrigation. GP pipe is used mostly for construction, like roof top. During a good monsoon season, irrigation demand comes down. When the monsoons are not good, people are forced to go for irrigation and when they go for irrigation, they use our galvanized pipes. Now we were lucky that this year monsoon was good in India, it meant that less of galvanized pipe was used. So you will not see that much of growth as you have expected.Last year, the monsoon was not good so GI pipe consumption was better. But going forward, the irrigation need increases, people in the rural areas will have something in their pockets, they will spend more. And we are basing ourselves on that market. GI demand should go up from November onwards. Already our October sales of GI pipe have been higher than average, which is just proving our point that the galvanizing demand is increasing because of the rural sector. And when GI and GP sales go up, EBITDA margins will also go up. Once the sales of higher sections of square and rectangle starts, again there will be slight improvement on an average. But let me tell you, the quantum of higher sizes, that is above 200 mm or above 150 mm is very small. So even though we may get higher EBITDA there, when you average it out, the impact will be very less.

Pawan Kumar The impact of the Direct Forming Technology(DFT)will be starting from FY18 onwards, is it right? Does FY17 have anything commissioned as of now?

Ashok Gupta Yes, nothing has been commissioned. Commissioning will take place maybe next month and then slowly it will get commissioned. So this year we will be focusing on commissioning, introducing the product in the market and there may be a marginal impact. But a significant impact will definitely be from next year.

Pawan Kumar The DFT pipes will be classified under which segment?

Ashok Gupta No, they will be classified as black pipe only. Because we do not coat them so they will be called as black pipe under the same category. Only thing is that we will focus on different segment but category will remain same, which is the black pipe segment.

Moderator Our next question is from the line of Pallav Agarwal from Antique Stock Broking. Please go ahead.

Pallav Agarwal On the capex outlay, out of the total planned capex, how are you going to phase it over FY17, 2018 and 2019?

Deepak Goyal This year we have a total capex plan of Rs. 250 crore. Out of this, around Rs. 125 crore for Raipur and Rs. 125 crore for the latest technology that is Direct Forming Technology.

Pallav Agarwal Could you give some guidance for FY18?

Deepak Goyal In FY18, we will introduce Inline Galvanizing facility, and some more capex on geographical expenses. So, till now, Rs. 50 crore is concluded for Inline Galvanizing, balance is in process.

Pallav Agarwal On the raw material sourcing for HR coils, given the volatility in pricing both internationally and on the domestic levels, so at current levels is it cheaper to import HRC rather than buy from domestic sources?

Ashok Gupta For the prices till October, if I import and with all the duties and all it would not be any big advantage to import it. But let us see how these steel producers behave in the months to come. If they continue to increase prices, but the international prices do not increase, in that case it may become viable. But till October, the prices of imported raw material and domestic prices were almost at the same level with very minor difference, which was not lucrative enough for anybody to import. So currently it is not lucrative, but days to come depending on the pricing, it can become better.

Pallav Agarwal The domestic steel players have taken price hikes in October as well. So given that the domestic prices are probably above the MIP reference levels of $474, if this persists then could we see more imports happening of steel?

Ashok Gupta Till October, whatever increase was given that has been taken care of. But if in November or December, if they again increase, then you can see spurt in imports, unless imported price also increase.

Moderator Our next question is from the line of Ankit Gor from Systematix Shares. Please go ahead.

Ankit Gor On our Chhattisgarh plant, what is the capacity and what is the capex there?

Sharad Mahendra Chhattisgarh is a very easily developing state, if you see the way they are developing Raipur and New Raipur, so we feel that in the days to come Chhattisgarh will be a big opportunity and that is why we have put up our plant there. In addition to that, it is also our entry gate to eastern region. Eastern region consisting of Bengal, Bihar and Orissa does not have any plant at the moment. We are trying to install a capacity of above 3 lakh tons per annum there, we hope to have six production lines and one galvanizing facility. Out of the six lines, at least one or two will be Direct Forming line. And going forward, our total investment in Chhattisgarhfor entire capacity of 3 lakh tons would be in the range of Rs. 125 crore to Rs. 150 crore. This may be spread this year and next year combined.

Ankit Gor If someone has to setup a 1 lakh ton capacity, what is the thumb rule capex for that?

Sharad Mahendra A lot depends on what quality of facilities that you are installing. We can install a garage facility; we can install a 5 star hotel facility. But typically assume that it will be around Rs. 60 crore - Rs. 65 crore if you want to put up a 100,000 capacity plant. But this is for a new plant, when you increase the capacity the incremental expenses are not so high because there are some expenses which are only for land and which are for the basic facilities. So going forward, suppose for 3 lakh tons typically amount will come to around Rs. 130 crore - Rs. 150 crore.

Ankit Gor How big is this eastern market in terms of size?

Sharad Mahendra India does not have a very good statistical system, so we do not really know the figures, we can only estimate based on our known information. So, we have a feeling that eastern region consumes around 1 million tons per annum, so hopefully this will go up because eastern region is now developing, so it will go to 1.2 million - 1.3 million.

Ankit Gor With regards to agri, when you see GI pipes picking up, volume is picking up in agri pipes but incrementally these PVC pipes become a substitute to us. So are we actually a substitute or a different usage is actually there or you see that GI pipes going ahead have a great future, but same thing is conveyed by PVC pipes guys also. So if you want to comment anything on that, that will be great for us to understand.

Ashok Gupta What happens is when the water is shallow, when I say shallow means 100 feet - 200 feet, then you can use steel pipe or you can use PVC pipe, it does not matter much. So people will tend to use PVC pipe because it is cheaper, but its life is lower so some people will go for steel, but it is either way. But water table in the country, particularly in certain region is going down and certain parts of Gujarat, in certain parts of Maharashtra and Karnataka it has gone as much as 1,000 feet. Above 250 feet - 300 feet, at the most 400 feet, plastic pipe cannot sustain because the weight of the equipment, basically is a submersible pump, that becomes so much and the weight of the pipe becomes so much that PVC finds it hard to take the load. Now this equipment is expensive, the motor may be costing Rs. 1 lakh or Rs. 2 lakh, maybe more, and the drilling is expensive, drilling of 1,000 feet. So what we have observed is whenever it comes to higher depth, depth of 250 feet or 400 feet, then we see people taking steel. For example Rajasthan, Rajasthan has a big consumption of steel pipes as against Haryana, Haryana has a good consumption of PVC pipe, because in Haryana the water table is 200 to 250 feet, in Rajasthan it is around 1,000 feet. So, in a way you can say these are two different markets, we only cater to the higher depth market, PVC caters to shallow market. But to some extent there could be an overlap.

Ankit Gor Growth of this GI pipes, is 15% growth achievable year-on-year?

Ashok Gupta Water table has been going down. If you see the World Bank figure, water table has been going down steadily in the country. And because you know the sources of water and drought that we are facing. So we think that the market has to grow because there is no substitute, till we come to an area when we can think of water conservation and water harvesting in a big way. So I hope water harvesting and water conservation starts in a big way. Some of it has started but not sufficient enough to take care of the country's need.

Ankit Gor The OEM opportunity is pretty large and currently 1.5% can go up to 15% in one and a half years time, so are strategies in place and things are happening correctly on the ground? Because it will be a huge jump in terms of revenue and it will open entirely new gamut for us, the OEM markets. So can you give some conviction on that?

Sharad Mahendra In the OEM market, we see there are various segments , one is that there are smaller OEMs which give basically the construction, like fire fighting with this construction in infra spend, which is now happening in the country and likely to continue going forward for next few years at least. Fire fighting is one big opportunity which we see, because without that this is becoming a standard norm and there we see a big opportunity across the country. So, definitely our presence right now is negligible. One is that, and apart from that the transportation growth which is happening, the bus body building also is a huge opportunity spread across the country. And there are many other small, segments, like the projects, small building which is coming maybe say G+6, G+7 wherein they want a faster construction, the builders and structural engineers are looking for options wherein the building gets ready faster, wherein the steel pipes play a significant role, into sections and all. So that is where the opportunity we see is available. In addition to that, those mega projects, when we go back maybe a few years back, Commonwealth Games time when we know that Jawaharlal Nehru Stadium was made, the kind of pipes and all which was a project which was done by Shapoorji Pallonji. So those kind of big projects which are now coming up in India with these flyovers and metro projects and other things, so our strategy is primarily to focus on the smaller OEMs and to have a long-term larger tie-up with big construction companies who are regular users of this. And with this Direct Forming Technology, the advantage is that they can get exactly the customized sizes of their need, they are not constrained by the availability of the size. So the structural engineers are going to play a key role wherein we are now establishing contacts with them that whatever they need is possible for us to give. So they do not have to compromise on the designing and drawing and provide them the most optimized solutions. So these are the opportunities we see. As I said that it will take some time because this is an approval process and we have already initiated, maybe next few months to a year we should be in a position to increase our OEM share significantly.

Moderator Our next question is from the line of Pritesh Chheda from Lucky Investment Managers. Please go ahead.

Pritesh Chheda What is the capital employed, debt figure and inventory figure?

Ashok Gupta Total capital employed is in two parts. One is the shareholder's fund, which as of date, is around Rs. 650 crore. Second, the debt is of the order of around Rs. 540 crore.

Pritesh Chheda This is both short-term and long-term debt, right?

Ashok Gupta Yes, both.

Pritesh Chheda What is the inventory figure?

Ashok Gupta Our inventory typically remains high, but now we have been able to bring it down to around Rs. 410 crore. And our debtors are normally in the range of Rs. 200 crore, so it is currently Rs. 215 crore.

Pritesh Chheda Why has the depreciation figure gone up?

Ashok Gupta Recently there was a change in system, whereby you can go for component depreciation. Earlier we used to go for the entire mill, now we can go for a small component. One of the components is rolls, now we use that provision and we are doing accelerated depreciation of our rolls, because rolls we can change faster now. And for both Q1 FY17 and Q2 FY17, we have put depreciation in Q2 itself, so you will see around 4 - 4.5 crore only on accounts of rolls. Plus, we had one mill, which became operational in Q2 that adds to Rs. 1 crore - Rs. 1.5 crore. So you will see increase in depreciation by around Rs. 6 crore.

Pritesh Chheda Out of that, Rs. 3 crore is sustainable, is it right? So you have depreciation of Rs. 17 crore versus Rs. 10 crore QoQ and around Rs. 8 crore YoY?

Deepak Goyal During last year, we had increase in depreciation because we had commissioned many mills. In Q2 FY17, we commissioned one mill, so you get another Rs. 1 crore here. But a significant part, which is around Rs. 4.5 crore to Rs. 5 crore, it came because of the roll depreciation. So rolls we are trying to do faster depreciation so as to get some advantage in taxation.

Pritesh Chheda Is this number sustainable?

Deepak Goyal Going forward, deprecation will be around Rs. 12 crore to Rs. 13 crore per quarter.

Pritesh Chheda So that is about 6% of your gross block?

Deepak Goyal Yes.

Moderator We have the next question from the line of Ashutosh Garud from Reliance Wealth. Please go ahead.

Ashutosh Garud Could you provide some clarification on the capex, which is Rs. 250 crore?

Ashok Gupta For this year, our total capex will be in the range of Rs. 250 crore, out of which Rs. 125-130 crore will go for the Raipur facility and Rs. 100 crore will go for all the mills which we are purchasing. So this capex is mostly in the line of capital work-in-progress because everything will not get commissioned this year, but that will be the net expenditure outgo from our side. So if I take two years, that is FY17 and FY18, that will get more meaningful because the plant will get commissioned next year. So, if I combine the two years my total capex in those two years will be between Rs. 300 crore to Rs. 325 crore.

Ashutosh Garud The water dispute in the South region impacted our growth rates. What were the other aspects which you mentioned?

Ashok Gupta There is no sales slowdown per say. If you see, still we have been able to garner 10% - 11% growth. And 10% - 11% growth is in pipe industry. Pipe industry as a whole, without having any authentic figure, say it hardly grew by 4% - 5% which is a natural normal trend. So, always during monsoon, there is a slight reduction because of the cyclic nature of the industry. When the monsoons are good, the season is good, and then the demand for pipes comes down. July - September we had very good rains, so all over the place,the requirement for GI pipe reduced, construction activity reduced so the demand came down. Water dispute, Kaveri dispute contributed only for a certain duration of 10 - 15 days, but throughout the quarter we had a effect of monsoon, because monsoons are good, but this is a positive effect. It is observed that whenever monsoons are good, the quarter may suffer but subsequently, particularly from November onwards you will see pick up till next year April, May.

Ashutosh Garud What kind of a volume growth rate you expect in next year or so?

Ashok Gupta We have been traditionally looking at 20% plus growth. Now that things are sustainable and things are going well and our new technology is coming up, we expect that in H2 also, we should be having 20% YoY growth. And definitely next year, with all the new mills coming up and Raipur plant also stabilizing, we are again targeting 20%.

Ashutosh Garud So in which quarter is the Raipur plant expected to be commissioned?

Ashok Gupta Initial commissioning will start in Q4 FY17, but real impact will come next year.

Ashutosh Garud So the full production would hit in Q1 or will it take time?

Ashok Gupta It will be ramping up, maybe some quantity will come up in Q1 and slowly it willramp up. For example, the total capacity is 3 lakh tons, so maybe in the first year we may be able to achieve a figure of around 70,000 tons to 1 lakh tons, but let us see how the ramping up takes place. We have not done the detailed calculations, but this is how the normal ramping takes place.

Moderator We have the next question from the line of Damodaran Kutty from Birla Sun Life. Please go ahead.

Damodaran Kutty On the Direct Forming technology, from your overall capacity, what component will that be and what sort of ramp up do you see for that?

Ashok Gupta The Direct Forming technology, we are installing at all our places in East, North, South, West. Currently as you see, we are producing around 10 lakh tons of pipes per annum. Direct Forming technology,capacity-wise, will be around 5 lakh tons. But again, it will be a gradual increase, it may start with 1 lakh ton may go over to 5 lakh tons in the periods to come. So we expect that our share of Direct Forming technology, particularly in black pipes will start with around next year maybe around 20% - 25% and going ahead it will be around 40% to 50%.

Damodaran Kutty So will this improve EBITDA by 3% to 5%?

Ashok Gupta It will take time because once you introduce something, people take time to test it and give you the real premium. Over a three year horizon, we expect that material from this technology will give us 3% to 5% higher margin than normal pipes.

Moderator We have the next question from the line of Kalpesh Gothi from Veda Investment. Please go ahead.

Kalpesh Gothi What is the EBITDA per ton for GI and GP pipes?

Ashok Gupta Our average EBITDA is around Rs. 3,500, so GI and GP EBITDA is much higher than that. It depends on state to state, place to place It varies, but average is around Rs. 4,000 to Rs. 5,000 per ton.

Kalpesh Gothi Many other competitors are putting up a plant in South. In the last six months, we have seen many plants being commissioned. So do we see any competition there?

Ashok Gupta Most of the plants which have come up, not only in last six months but in last three, four years, were small plants. What happens in small plant is they are not able to offer the entire range and today customers do not want to go to five different suppliers for the same product. So they are not able to create, so many of them have closed down as well. But this relation will always continue, some people will come and some people will not be able to sustain, the process continues. At this moment,I am not able to see any large plant which was able to come, which has come or which is continuing. Maybe some investments will come in some small way or medium way, we will have to see when they come up.

Kalpesh Gothi Can you give more insight about the Southern market, what is the demand and what is the supply and how much capacity are we catering to the South?

Ashok Gupta Demand data in the country is not really available from any published source. We have our own estimates based on collection of data of various producers, which again nobody gives a correct figure, so it can only be a guess work. But our idea is that the demand in Southern region is of the order of 2 million tons to 2.4 million tons per annum. We are selling about 0.4 million tons - 0.5 million tons there and there are not many other producers. So we are the largest producer there. Demand is growing in Southern region because a lot of development is taking place. While development is taking place all over India, we definitely see a higher level of development taking place, particularly in the states of Tamil Nadu, Kerala, Karnataka, Andhra Pradesh and Telangana. So we see our growth being faster in the Southern region as compared to the average of our country.

Kalpesh Gothi Can you give me average realization per ton in South and EBITDA per ton particularly in South?

Ashok Gupta I can give you average realization for the country, not only for the Southern region because there is a lot of cross state movement taking place. So our average realization today is around Rs. 38,000 per ton, but region wise, state wise there are variations. But let me give you a general ballpark position, our realization and EBITDA in South is good. And 40% sales come from South.

Kalpesh Gothi Three listed players are commissioning their plant and although you have said the size of their plant is smaller, but their plan is to execute by FY18 or FY19, so where do you see sustainable growth?

Ashok Gupta We are conducting a big branding exercise. Today customers want two things, A) trust and faith in the brand that they are buying, B) ready availability, convenience and comfort. We are taking steps to provide all this. Obviously competition will come, no industry can be isolated from competition, so we are readying ourselves to the future competition. We are undertaking a big branding exercise. Already our brand is very well accepted in the Southern region; in fact we are the brand leader there and by a significant margin. There is no second important brand which is anywhere close to us. But we are further strengthening it, we are not sitting on that. So we are making sure that our brand presence and brand acceptance is very high there. Our first Direct Forming line will be commissioned in South and it will offer a great product.We are also bringing a new technology that is In-line Galvanizing, that technology's product almost looks like stainless steel. There is so much difference between their product and what we are producing today, we ourselves are surprised. Last month, we had some visitors from Japan and they brought some samples from this technology, and that is why we went for this technology because the product itself is so clearly visible and this product is used in roof tops. The average life of a GP product in Kerala is about 10 - 15 years; this product will have a life of 30 to 40 years. So lifecycle, economical cost and production cost is lower. And we have a contract with the supplier; he cannot give this technology to anybody for the next three years, so we are taking these steps.

Kalpesh Gothi In the current 2.5 million ton of demand, how much gets imported from other states?

Ashok Gupta It will be difficultbecause no data would be available. But again, my guess work will be around 15% or so coming from other states.

Moderator Our next question is from the line of Manish Jain from SageOne Investment Advisors. Please go ahead.

Manish Jain The inventory figure compared to March 31, 2016 to September 30, 2016 has declined from Rs. 594 crore to approximately Rs. 400 crore. So, is it actual physical reduction of inventory or is there an impact of price decline as well?

Ashok Gupta It is just a physical decline. The prices were increasing from February onwards, so in January we had done some contracting for imports, so we had both imported inventory and domestic inventory with us, which are relatively higher inventory levels. This continued to about June - July, from June - July we started reducing our inventory level. In addition to reduction inventory, so far as raw material prices are concerned, the raw material prices as on 1st April and 1st October are almost of the same level.

Manish Jain We do not have any inventory losses?

Ashok Gupta No, we do not have any inventory losses.

Manish Jain Where is the debtors figure in the balance sheet?

Ashok Gupta Currently, our debtors are around Rs. 212 crore and we ended last year, i.e. 1st April figure was at Rs. 219 crore, I will say they stayed where they were.

Moderator Our next question is from the line of Jignesh Kamani from GMO & Co. Please go ahead.

Jignesh Kamani On payback side, you will be spending close to Rs. 125 crore for whole Chhattisgarh plant, so assuming around Rs. 3,500 EBITDA per ton, you should be doing close to Rs. 100 crore EBITDA probably one or two years down the line. So in less than two years, we would be able to recover the entire capex?

Ashok Gupta I will be cautious, because the eastern market is untested water for us, we do not know what kind of EBITDA margins we will achieve. Our target will remain around Rs. 3,000 to Rs. 3,500 but it may take some time. But our target is that we should be able to have a payback period of maximum three years.

Jignesh Kamani In that case, when the payback period is very healthy for the industry, what will prevent other small players to invest in various plants and be more a national player rather than being a regional player? Because if we are taking around two to three year payback period, a small player can easily do it with five year and it is also healthy for them.

Ashok Gupta This is a low EBITDA margin industry. If you observe, EBITDA margins are in the range of 7% - 8%, maximum going to 9%. How do we manage 7% to 9% of EBITDA margins? One is through scale of operations - because of scale of operations our production cost comes down by 1% -0.5%. Second is purchasing - we are the largest buyer of HR Coil in the country. Now as compared to any other small player, any supplier, particularly steel industry going through what kind of surplus it is going through will be ready to offer us 1% to 1.5% discount as other players. In fact, the discount that I get with respect to other players is much higher. Third is premium - because of the brand name we have,we are able to get a premium over most of the players, in fact our target is that we should be getting a premium of 2% to 2.5% from any other player. And there is another fourth element that is rate of interest itself. It does not come in EBITDA, but my rate of interest is 8.5% average while other people are paying 11.5%to 12%. So these kind of cost advantages not many people get. Because of my long history I have been able to get a lot of my profits again into my system, so that is giving me a place whereby I am able to work with low leverage. So these are the advantages that new players do not get. Seeing EBITDA of 8% - 9%, seeing that this industry is getting advantage of 3% - 4% as it is, if you see EBITDA level of many other players it is in the region of 3% - 4% and 3% - 4% is not sustainable.

Jignesh Kamani Right now, our receivable days is pretty healthy, less than 20 days on an average.So when we increase our OEM share from 1.5%to around 10%, how is the receivable cycle in OEM going to play out?

Ashok Gupta Our OEM sale today is hardly 1% - 2% and it is supposed to go to 10% - 15%. So, OEMs typically have receivable days of 30 days, so we expect that on an average it may go from 20 to 21 days otherwise for 20.5 days. We will definitely try, but there will be some increase, it may be marginal, a day or so.

Jignesh Kamani So incrementally it would not be ROC dilutive because of the high receivable cycle?

Ashok Gupta No, impact will be less because it will be hardly 10% - 15% of our sales. In days to come, it will go up but then the margins will also go up, EBITDA margin will also go up.

Jignesh Kamani Earlier, we used to capitalize our advertisement expense for a period of three years and now we are charging everything on a particular year. And also our brand building exercise will be much stronger now. Despite that,are you confident of maintaining Rs. 3,500 per ton or because of the higher advertisement cost there will be some pressure on EBITDA per ton?

Ashok Gupta In fact, we do advertisement branding to improve EBITDA per ton. Presently I am struggling to get a premium of 3%, with branding people have been able to achieve much higher premiums. We are going about it in a very different way, we are not going in a typical way of just going for a TV ad. Next three months, we are doing market research in finding out what does a customer want. Tomorrow you will not see our ad on TV, we are initially investing a lot on understanding the consumer behavior. Whole idea is that there should be a pull for our product, and once the pull comes I am sure premiums will follow, and once premium follows EBITDA will improve.

Moderator Our next question is from the line of Pawan Kumar from Unify Capital. Please go ahead.

Pawan Kumar Can you share any capacity utilization numbers, segment wise and are the capacities actually interchangeable between GI, GP or black?

Ashok Gupta Whatever pipe mill we have currently, in all the mills the products are interchangeable. So we can make round, or square or rectangle in the same mill. Only galvanizing is a subsequent process. So of my total production capacity, around 25% to 30% I can galvanize, maybe 35% maximum. So that is the capacity wise position. Now utilization, typically in this industry, it varies from 75% to 80%, so here also our utilization is in the range of 75% or so. Since we are expanding the capacity faster, you will see utilization figures remaining at 75%- 80% or even below 75%, whenever new capacity comes up. Once it ramps up and the new capacity gets fully utilized then it will again come back to 75% - 80%. And the reason for 75% - 80% utilization is because it depends on the thickness and diameter. You will produce the same meter of pipe but if the thickness is less, then the tonnage will be less. So 75% - 80% is a good capacity utilization.

Pawan Kumar Regarding the trading revenue, what are the kind of revenues we are expecting from trading this year and what is our general philosophy behind it?

Ashok Gupta Trading is an opportunity-based business. At times, we see a good arbitrage when we import something and there are people who want to buy it even on high seas and we make some margins out of it. So it is purely an opportunity based business, if we see some margin 1% - 2% then we will go for it. But where it helps us is that whenever we are doing some imports then people can club quantities and when you club quantities you get better prices. For example, we are importing some 20,000 tons and a customer comes up with a requirement of 5,000 tons, both of us gain. Those 5,000 tons when we sell, we will make some margins. It is only opportunity based, trading is not our main business.

Pawan Kumar Can we say maybe Rs. 600 crore this year is on trading or will it be relatively less?

Ashok Gupta It will be less, because opportunities till now have been limited. Going forward, let us see how the prices play. Because it depends on arbitrage, if domestic prices are higher or import prices are higher. So based on that, we will take a decision.

Moderator Our next question is from the line of Damodaran Kutty from Birla Sun Life. Please go ahead.

Damodaran Kutty You mentioned that you will be increasing your focus on branding. So what would be the spends that you are envisaging for FY17 and FY18?

Ashok Gupta We are budgeting around Rs. 20 crore - Rs. 25 crore for next year, but that is only the budgeting. How much actual spend goes will depend on other factors. We are surveying customers and consumers, we will try to find out what exactly they are looking for, then we will have our communication strategy. And based on the communication strategy which will be ready hopefully by end of this year, they will have the real number. But to begin with, we are just keeping a budget of around Rs. 20 crore - Rs. 25 crore, actual numbers may be slightly lower.

Damodaran Kutty What would be your premiums roughly across all your different products vis-à-vis your competition?

Ashok Gupta Competition is very different. Competition can be very, very small players, competition could be medium players. Our normal thinking is that we should get at least 1-2% more than the smaller players. Typically, we have not been able to go for much higher premium because industry is quite competitive. With branding, we are expecting that our premiums will improve to 2% to 3%.

Damodaran Kutty And will this help you to maintain your EBITDA margins that you are guiding of about 8%?

Ashok Gupta Our internal target is much higher, because when we are spending so much money and are creating a buzz around our brand name, we expect that people will give us better money.

Damodaran Kutty Is your branding going to be focused on any particular product?

Ashok Gupta It will be more in terms of the brand name, because what we are doing is we want to create a trust amongst people. For example, today people have a lot of trust on Tata despite whatever may be going on, so we want to create a similar trust, a trust where people will say that yes this particular brand they can look upon, and it has got substance. So we are basically creating a trust in the brand. But while doing so, obviously we will keeping some products in the limelight and those products will be products like our Direct Forming, like our Inline Galvanizing, that will be kept at the forefront.

Moderator Thank you. Ladies and Gentlemen, that was the last question for today. I would now like to hand over the floor to the management for their closing comments. Over to you, sir.

Ashok Gupta I must thank all the participants. It gave us really good insight into what the investors are looking for. It will also enable us to draw out our own strategies. I can assure in days to come the company will perform better, we are already taking all the right steps and hopefully you will see better results in days to come. Thank you so much for your participation.

Moderator Thank you very much, sir. Ladies and Gentlemen, on behalf of APL Apollo Tubes Limited, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.