"Oriental Carbon & Chemicals Limited Q3 FY19 Earnings Conference Call

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Moderator: Ladies and gentlemen, good day and welcome to the Q3 FY2019 Earnings Conference Call of Oriental Carbon & Chemicals Limited. This conference call may contain forward-looking statements about the company, which are based on the beliefs, opinions and expectations of the company as on the date of this call. These statements are not the guarantees of future performance and involve risks and uncertainties that are difficult to predict. As a reminder, all participant lines will be in the 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 phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Akshat Goenka, Promoter and Joint Managing Director of OCCL Limited. Thank you and over to you Sir!

Akshat Goenka: Good morning and a very warm welcome to everyone. Along with me, I have Mr. Anurag Jain, our CFO and SGA, our Investor Relations Advisors.

I hope you have received our result and investor presentation by now. For those who have not, you can view them on our website.

The performance of the company for the first nine months of this financial year has been good. This year we have posted good growth over last year. During this year, we have been able to successfully start commercial production of the second phase of expansion of insoluble sulphur of 5,500 metric tonnes per annum capacity at Mundra ahead of the scheduled time.

The auto industry is undergoing a major change in India with low emission levels, enhancement of fuel efficiency in vehicles, the Indian tire industry is embracing all these new trends in the manufacturing process to meet the changing market dynamics and cater to the latest demands of the OEMs. The latest trends in the industry include finer tolerance in the manufacturing process, inclusion of more radials which consume less fuel, low rolling resistance **(**and focus on better traction and on-road performance, which in turn increases fuel efficiency.

Growth in the domestic tire industry has picked up in the last year. Domestic CV companies are launching many newer variants, which is expected to boost demand for commercial vehicle tires. Radiationalisation in this segment continues to grow and has touched approximately 7% of truck OEMs while it is approximately 40% in the truck replacement segment. Further low cost radial imports from China have declined sharply due to the implementation of anti-dumping duty, which has benefitted domestic companies.

Demand of commercial vehicles is also expected to increase driven by the increased investments by the government on infrastructure and manufacturing. The global tire industry has already done a capex of over Rs.50,000 Crores, and a further Rs.15,000 Crores is invested in ongoing Brownfield projects across India and Asia. Most of the global tire manufacturers have setup new capacities in and around Asia.

With OCCL having long-term relationships with all of them, we have huge opportunities in the coming future. We have continued to strengthen our ties with all our major customers and we continue to enhance our footprint across all domestic and global consumers and remain in a strong position to capture higher market share as new capacities come in.

Now I would like to handover the line to Mr. Anurag Jain to update you on the financial performance of the company.

Anurag Jain: Thank you Akshat. I will take you all through the financials of the company.

Revenue for Q3 FY2019 is Rs.96 Crores compared to Rs.88 Crores in Q3 FY2018 a growth of 10%. Revenue for 9M FY2019 is Rs.289 Crores compared to Rs.242 Crores in 9M FY2018, a growth of 19%. This growth was mainly on account of increased capacity utilizations and rupee depreciation.

For Q3 FY2019 EBITDA stood at Rs.36 Crores, a growth of 32% from previous year. EBITDA margin for Q3 FY2019 stood at 37.6%. For 9M FY2019 EBITDA stood at Rs.96 Crores, a growth of 23% from the previous year. The EBITDA margins for 9M FY2019 increased by 110 basis points to 33.3%.

Profit after tax for Q3 FY2019 was up 35% to Rs.20.7 Crores. PAT margins for the quarter increased by 410-basis points to 21.5%. Profit after tax for 9M FY2019 was up 29% to Rs.54.7 Crores, PAT margins for the 9MFY19 increased by 150 basis points to 18.9%.

With this I would like to open the floor for questions and answers.

Moderator: Thank you very much Sir. Ladies and gentlemen, we will now begin the question and answer session. Ladies and gentlemen, we will wait for a moment while the question queue assembles. We have the first question from the line of Abhisar Jain from Centrum Broking. Please go ahead.

Abhisar Jain: Good morning Sir. Congratulations for good set of numbers. Sir, my question is on the MTM forex gain in this quarter. What would be that amount please?

Anurag Jain: The forex gain in this quarter is around Rs.3 Crores.

Abhisar Jain: Do you have that number for Q2 FY2019?

Anurag Jain: For, Q2 FY2019, forex gain was Rs. 3 Crores

Abhisar Jain: Sir, for 9M FY2019 is there no forex number?

Anurag Jain: You are right. For 9MFY19 there is no forex gain.

Abhisar Jain: Sir in terms of the revenue growth you have mentioned that it is largely due to increased utilisation and Rupee depreciation, so that means in terms of the realization the dollar per tonne realization has largely been flattish in FY2019 over FY2018, right?

Anurag Jain: In international markets prices have been stable..

Abhisar Jain: Sir, for the period ahead, are you seeing any trends specifically which are off from this trend , with respect to the realization, how is trajectory that you see from here?

Anurag Jain: We are not seeing any major deviation in the realization in terms of dollars and Euros. However, it could differ depending on the exchange rate.

Abhisar Jain: One question related to EBITDA that despite adjusting for the 3 Crores forex gain it seems that the margins have done quite well and we are seeing other expenses particularly being on the lower side and is that all due to operating leverage, economies of scale or is there any other savings also which we are seeing in that line item?

Anurag Jain: As we have said that in the long-term we project our EBITDA to be in the late-20s range,. The 2% jump that is there in EBITDA is because of sulphuric acid and that is the only one difference which is there in this quarter.

Abhisar Jain: Higher realization benefit is there only in the sulphuric acid revenue stream, right Sir?

Anurag Jain: Yes.

Abhisar Jain: Just getting a little bit more sense on the capacity utilisation, so would you be able to comment that now the first line of Mundra which we commissioned earlier, so is that line fully ramped up now? Also, line 2 would still be under ramp up phase and by when is that line expected to be ramped up fully?

Akshat Goenka: Line 2 is not yet been optimally utilized and I think the ramp up of line 2 would take us through the next financial year. So, I think without getting into specifics what I would like to say is that with our current capacity utilisation there is plenty of room to grow and for operating leverage to kick in.

Abhisar Jain: That is very helpful. Just last one question from my side. Going ahead, when do we think that we would be able to decide on the expansion because it takes some time to get the line on stream?

Akshat Goenka: We are working towards taking approval in the month of May from the board. We are doing a lot of background work and that is the internal target we have set ourselves as of now.

Abhisar Jain: Thank you so much Sir. Best of luck.

Moderator: Thank you. We have next question from the line of Pritesh Chedda from Lucky Investment Managers. Please go ahead.

Pritesh Chedda: Sir, I just wanted to know what is the capacity utilisation for the 9MFY19 and what is the volume growth for the 9MFY19 ?

Akshat Goenka: We do not share these numbers

Pritesh Chedda: On this opex side, I understand your comments on FX , but even after considering the impact, if I look at the other opex line item, which from a Rs.31.5 Crores is down to about 25-odd Crores, so is there any other provision write back or anything which has gone to that line item?

Anurag Jain: No provision or write back is there in case of that line item.

Pritesh Chedda: Incase of the above line item, if I look at same quarter last year that number was about Rs. 27 Crores, preceding quarter it was about Rs.31.5 Crores and now it is roughly about 25 Crores, so is there any particular line item where we would have seen significant cost savings may be in case of power or fuel?

Anurag Jain: There are savings in power and fuel, but they are not very significant. As Akshat has pointed out that this savings would be there as long as we keep optimising our capacity utilization.

Pritesh Chedda: So in absolute number also is there savings available, when we say that we can optimise cost? Even if there is more costs it will be spread out over higher contribution margin or higher production number?

Anurag Jain: There are two aspects of this. Some costs will be spread over higher production capacity and there are some costs in a chemical plant, direct costs which do come down, if the plant capacity utilization is ramped up

Pritesh Chedda: I understand that you do not give guidance, but going forward this Rs. 25 Crores per quarter number, is this the number that looks more sustainable?

Anurag Jain: Our guidance going forward is that we look at late 20% as our EBITDA margin and if we maintain the topline yes, then it should be in that line.

Pritesh Chedda: Thank you very much Sir.

Moderator: Thank you. We have the next question from the line of Chirag Dagli from HDFC Asset Management Company. Please go ahead.

Chirag Dagli: Thank you for the opportunity. Sir, when do you see insoluble sulphur prices sort of improving from here given that they are we are almost two to three year low, is there something that you think can play out?

Anurag Jain: First of all,I do not know from where you found out that the prices are two to three years low. Secondly, I think they have been stable over the last years and we are looking at stable prices in the near future in terms of dollars and Euros.

Chirag Dagli: Okay. Sir, you mentioned about operating leverage. So where is this operating leverage that you are seeing once we scale up

Anurag Jain: For example in a chemical plant, , if we are growing form 85% or 95% capacity utilisation the leverage improves because the cost of utilities, power, steam does not go up pro-rata. So even if there is a movement from 80% to 90%, 90% to 100% the cost of utilities for the sector remains nearly the same and that is where the leverage lies. Other than the fact, of course the fixed cost gets spread over more quantity.

Chirag Dagli: Sir, is there any further scope for margin improvement? As our margins are already reasonable, currently at ~32%, do you think they can improve further from this point?

Anurag Jain: I would say that with the current margin levels, , we have more room to face any markets uncertainties in the future.

Chirag Dagli: Has depreciation sort of peaked out ? Has all the incremental that needed to get in, already been realized?

Anurag Jain: Depreciation has peaked out for the current level of capitalization.

Akshat Goenka: To answer your question, I think, depreciation and interest has peaked out or it is close to peaking out. And also the deferred tax should be peaking out, if not peaked out.

Chirag Dagli: Thank you Sir.

Moderator: Thank you Sir. We have the next question from the line of G. Vivek from GS Investments. Please go ahead.

G. Vivek: Good morning. Thanks for the opportunity. Just wanted to know about the capex plan for the company? Basically are there any capex plans in the near future or will it still take two to three years till we fully utilize our current capacity? Second question is about our subsidiary Duncan Engineering and how has it turned around and how sustainable is that?

Anurag Jain: So, the answer to the first question is I think we have already answered that that our current capacities are ought to be utilised optimally in the coming year and therefore obviously we would be planning for further expansion and we will let you know once the proposals are approved by the board and then we will make it public. As far as Duncan Engineering goes, Akshat will answer this question

Akshat Goenka: See, on Duncan Engineering as I always maintained this year we would have a profitable year and first nine months reflects that. it is very sustainable because even these results have a lot of one-time expenses that have been attributed to the P&L and in the next year these things would not be there, so things should further improve going forward in that subsidiary.

G. Vivek: What is the opportunity size for this subsidiary?

Akshat Goenka: It is too early right now to discuss any details.

G. Vivek: What is the opportunity size for our main IS business in India?

Akshat Goenka: In terms of the opportunity size for our main business we are roughly looking at adding one line every 18 months to two years.

G. Vivek: How has been the response for our product, since China and US being competitive market and in US so far it was Eastman who had monopoly? and how has been the response for us over there? with regards to China, as there is sort of a new development happened in the last one year for us I believe? How has been the response for the quality for our product in terms of helping us to score our competition in China ?

Akshat Goenka: As far as the US goes because it is a very mature market, we are doing well in that process. We are making inroads. We started supplying to one or two players and we have trials undergoing in some other places, and hopefully the true fruits of the groundwork done in the US should start coming in the next calendar year. As far as China is going, we have had some successes and we are trying to improve it further.

G. Vivek: In India there is this new highway constructions and eastern peripheral and western peripheral ban on overloading. Are these happenings is having some beneficial impact on our businesses and how are the other things?

Anurag Jain: India is doing decent.

G. Vivek: Have we more or less been able to have a breakthrough in almost all the tire majors in the world or are there still some names where we are still awaiting approval and also in terms of the supplies ?

Anurag Jain: We do not give out specific information, but naturally when we say the headroom for growth that means that there are untapped opportunities.

G. Vivek: Thanks a lot. Keep up the good work. Thank you.

Moderator: Thank you. We have the next question from the line of Digant Haria from Antique Stock Broking. Please go ahead.

Digant Haria: I just had one question, that at the full capacity utilisation, I am assuming a stable prices of insoluble sulphur across geographies where the company has presence .and From the current capacities along with line number two, can we expect to have a revenue of Rs. 450 Crores to Rs.500 Crores or will it be too difficult to put a number there? What is the turnover that the company can achieve at full capacity in may be next year or year after that?

Anurag Jain : Unfortunately, we cannot share the information because again that would tend to give the turnover that we have today in terms of tonnages. So that is what I cannot give, but we have told you the last line is not fully utilised and once that is utilised then the turnover should improve.

Digant Haria: Thank you so much. That was it from my side.

Moderator: Thank you Sir. We have the next question from the line of Abhishek Dutta from Prabhudas Lilladher. Please go ahead.

Abhishek Dutta: Just wanted to get some sense on how is the tire demand in the Indian market specifically in light of reports of demand slow down especially the replacement demand slow down in the Indian markets?

Akshat Goenka: Demand slow down is not yet being felt by us. I think, if there is a demand slow down and if things do not pick up, there will be a lag effect to this. But in any case the demand uptick and all has been very good, so even a small slow down here or there is not going to impact us that much.

Abhishek Dutta: How is this situation in China given the fact that there are reports that the market over there degrew quite sharply last year?

Anurag Jain: Our China market share is small therefore the growth and degrowth of the market is not significant to us.

Abhishek Dutta: Incase there is any downturn in Chinese markets , will that competition not spill over to your space?

Akshat Goenka: No that will not impact us. I mean obviously if the Chinese market suddenly drops by 20% to 30% or big numbers then there maybe some impact not at the levels we are seeing right now.

Anurag Jain: In case if the Chinese market drops and if the tire demand in the world remain the same. obviously that portion will shift elsewhere. So the overall consumption will not be impacted by some drop in China production because of US sanctions. The necessity is to see is that whether the overall growth in tire demand stagnates or comes down worldwide.

Abhishek Dutta: Lastly, does the demand supply situation and the capacity utilisation levels for IS remains closer to 90% at global level?

Anurag Jain: Globally I would say, yes, around 85% would be the figure.

Abhishek Dutta: Thank you so much Sir.

Moderator: Thank you Sir. We have the next question from the line of Abhisar Jain from Centrum Broking. Please go ahead.

Abhisar Jain: Thanks for the opportunity again. Sir, just wanted some colour from you on the volume growth that we might be clocking in FY2019 in domestic and export market? Could you provide the range?

Anurag Jain: Domestic we are doing good. Our growth is in double-digits in the domestic market. As far as exports are concerned, globally the market is growing at around 3% to 4% and we are growing at a pace which is better than the global market growth.

Abhisar Jain: Understood Sir. In China and US market, approximately of our total volumes that we are doing today, is it safe to assume that we would be now having double digit sales going into the US and China?

Anurag Jain: We have not reached the level that we would like to and we are still lower than 10%.

Abhisar Jain: What would be our maintenance capex pending for now, before any other capex announcements come? What will be the maintenance for both the plants combined?

Anurag Jain: Going forward maintenance capex should be in the range of Rs 5 Crores to Rs 7 Crores.

Abhisar Jain: Thank you so much Sir. Thanks a lot.

Moderator: Thank you. We have the next question from the line of Pritesh Cheddha from Lucky Investment Managers. Please go ahead.

Pritesh Cheddha: Thank you for another opportunity. Sir, just wanted to check if I look at our market share somewhere around FY2016, of the total market of 258 KT, our production capacity was about 23 KT and now when the market is doing about 300 KT and we are at about 34KT so incrementally we have been taking about 25% to 27% or 26% to 30% market share versus our original market share which is less than 10%, so if you could help us in terms of how competition is behaving? Are the other players not expanding capacity or are they not looking at the markets so aggressively? What would have we done so differently and going forward how would that sort of pan out in terms of incremental market share?

Akshat Goenka: It is very clear that when some players have a huge market share like Maruti did in India some years back obviously the growth is shared more by the smaller players. In this case, by FY2016, nearly 85% of the market was held by Eastman, so obviously their share in the overall growth would be less and ours would be more in that kind of a market and that is what has been happening.

Pritesh Cheddha: Are the tyre manufacturers incrementally looking at second source?, What factors are driving our incremental market share? Is it the pricing competitiveness or the second suppliers ,which factor is driving it?

Akshat Goenka: Yes that is one of the factors. Everybody wants a second supplier. It is one of the key factors in terms of growth for us which is more than the market growth. And of course it helps being in India which is a high growth region in case of insoluble sulphur consumption .

Pritesh Cheddha: Whatever incremental aggressive market share that we have gotten would be driven more by domestic or any other reason?

Akshat Goenka: Well, I did not say that it will be driven by domestic. I said it helps, so both the factors are at play.

Pritesh Cheddha: Let us assume that if India is growing faster than the world plus the fact that tyre manufacturers are looking at diversified source of material, would that continue to drive our market share vis-à-vis competition?

Akshat Goenka: Yes.

Pritesh Cheddha: Thank you.

Moderator: Thank you. We have the next question from the line of G. Vivek from GS Investments. Please go ahead.

G. Vivek: Sir, we have one of the highest margins in the sector and will it not attract the competition in today's competitive world? What is the mote we have in terms of entry barrier? Is it the technology or the relationship we have with the major tyre manufacturers in terms of approval process ? How sustainable is that ?

Akshat Goenka: When you say that we have the highest margins vis-à-vis the sector, what do you mean?

G. Vivek: I am not talking specifically, but overall 29% to 30% is a very decent margin which might attract competition. What about the risks associated with it?

Anurag Jain: There are entry barriers a)in terms of technology, b) it is a high capital intensive project to setup and then when a new person comes in it takes two to three years to get all the approvals done, so you have actually spent the money and you are running the plant for three years with all the overheads without any sales., All these things are barriers.. If you look at insoluble sulphur, global market, you know how much is the demand, if you multiply with the number you will find out that it is not very significant vis-à-vis the whole scenario worldwide. Therefore there is very less space for a fourth player to come in and get approved by tyre companies and make place for himself.

G. Vivek: Very nice to hear Sir. Could you throw some light on about our expansion plan? Would we like to go in for a Brownfield expansion or a Greenfield expansion?

Anurag Jain: We are finalizing. Once we finalise our plans as per the schedule already given out by Mr. Akshat Goenka we will come out and we will announce it to the public.

G. Vivek: How is the sulphuric acid business doing ? I believe all the sulphuric acid manufacturers in India were having some tailwinds due to Vedanta plant closure, so any focus in that or do you have plans of expansion for that?

Anurag Jain: Vedanta plant closure is not something, which is permanent. Obviously we also had tailwinds and so yes it did well this year.

G. Vivek: Currently no plans of expanding in that area? Is that not our focus area ?

Anurag Jain: Our focus area is in insoluble sulphur.

G. Vivek: Thank you.

Moderator: Thank you Sir. We have the next question from the line of Sarika Kukshya an individual investor. Please go ahead.

Sarika Kukshya: Thank you for the opportunity. One observation, that our enhanced capacities have not been able to contribute to the topline, and another observation on the manufacturing cost, it has significantly gone down and that has kind of contributed to our margins substantially. So just wanted to understand the key attributes to the deduction in manufacturing cost?

Anurag Jain: See, the new line has not been fully utilised as we have discussed earlier also. As far as raw material costs are concerned, they remain at around the same percentage approximately,ie 27%.

Sarika Kukshya: I am trying to understand on the manufacturing side, it has actually gone substantially down from 31% to 27% as a percentage of topline and mainly it happens whenever there is a kind of improved volumes on the topline. So we have not seen this kind of movement this time around, but despite the fact we have seen the increment on the manufacturing front. So just wanted to get an understanding?

Anurag Jain: So you are looking at cost of material and change in inventories, right?

Sarika Kukshya: Yes. The two line items, operating and the manufacturing items

Sarika Kukshya: The manufacturing and the operating expenses, which is Rs 25 Crores.

Anurag Jain: Rs. 25 Crores is other expenses, which has come down from 31 Crores to 25 Crores that is mainly on account of exchange rate difference. Earlier we said that last year there was a mark-to-market loss of Rs.3 Crores and this year there is a mark-to-market gain of Rs. 3 Crores, so that makes a difference of Rs. 6 Crores.

Sarika Kukshya: Thank you.

Moderator: Thank you. Due to time constraints, we are taking the last question. We have our last question from the line of Manish Jain an individual investor. Please go ahead.

Manish Jain: My question was regarding sale of Q3 FY19 vis-à-vis Q2 FY19, it has reduced from Rs. 98 Crores to Rs. 94 Crores. Is it due to volume reduction or due to only exchange difference?

Anurag Jain: s Typically during the December quarter sales are a little lower because most of Europe goes under shutdown for about 10 to 15 days in the month of December around New Year. So the dispatches get affected in November and December, so there is a slight effect of that in the December quarter.

Manish Jain: But I was checking over the last few years, I was not able to see that delta from September to December?

Anurag Jain: Because last few years there was higher growth rate. So that was getting neutralized.

Manish Jain: Are the volumes more or less in line with what we are expecting?Is the capacity utilisation reducing?

Akshat Goenka: Capacity utilisation is not reducing..

Manish Jain: That is what I wanted to know.

Moderator: Thank you very much Sir. Ladies and gentlemen that was the last question. I now hand the conference over to the management for closing comments. Over to you gentlemen!

Akshat Goenka: I take this opportunity to thank everyone for joining on the call. I hope we have been able to address all your queries. For any other information kindly get in touch with Strategic Growth Advisors or any one from our team. Thank you once again.

Moderator: Thank you very much. On behalf of Oriental Carbon & Chemicals Limited that concludes this conference. Thank you for joining us. You may now disconnect your lines.