
India, July 24, 2009

Analyst / Investor Conference Call

First Quarter of Financial Year 2009-10

Ramnath

Subramaniam:

Good afternoon to all of you. On behalf of IDFC-SSKI Securities, I welcome you all to the Q1 FY10 post results earnings call of Apollo Tyres. I also take this opportunity to welcome Mr Gaurav Kumar, Group Head, Corporate Strategy and Finance; Ms Ritu Jain, Divisional Head, Corporate Strategy; and Mr Rakesh Dewan, Divisional Head, Accounts.

Gaurav Kumar:

Good afternoon everyone. Thanks for joining the call. We will quickly go through the summary of the quarter. The net sales at Rs 11.8 billion were up by 10% and on an overall basis, for the Indian Operation, 2% of this came from volume and 8% from price. While the volume growth was just 2%, the positive is that it was essentially coming from the replacement market. For example, in the truck segment replacement market, we had a growth upwards of 10% which was offset to some extent by lower volumes in OEM and exports. This resulted in a mix change, which coupled with the price increases taken last year, was a boost to the operating margin, which was at 16.5%. The second major input for this improvement was raw material costs which were down by 12% vis-à-vis the same period last year. Other major significant fact was the other expenses which were higher compared to the same period as a result of a few growth opportunities which were pursued, but did not materialise or were dropped.

Moving on to South Africa Operations, it recorded revenues of Rs 2.5 billion. The South African economy continues to face tough times and there has been a significant fall in demand, putting pressures on the operations there. This has resulted in a breakeven situation, or a very small positive profit.

Our Operations in Netherlands, acquired on May 15, 2009, have been consolidated for 45 days in the current quarter and they have contributed Rs 2.1 billion to the overall revenue and have been at a breakeven level.

At a consolidated level, our revenue has been Rs 16.3 billion for the full quarter, up 24% vis-à-vis last year, out of which 16% contribution is from the inorganic businesses and the balance from India. The consolidated operating profit was Rs 2.1 billion at 12.7% and the net profit at 4.5%. That is all from my side. If there are questions, we would be happy to take them.

Bhagesh, HDFC:

Now that you have declared the results of the European acquisition along with the standalone numbers, can you disclose the acquisition price as well as the debt on the consolidated entity?

Gaurav Kumar:

Bhagesh, as we have mentioned earlier, Amtel which was the parent company and went into bankruptcy, continues under bankruptcy with some of its Russian subsidiaries still under negotiation with potential purchasers. There is a regulatory constraint on us to remain discreet on acquisition valuation details till all the assets are disposed of. We do not have any timeframe on this, but from what we know, active dialogue is on

and as soon those assets are resolved, we would be in a position to share the data.

Bhagesh: Can you disclose the operating profits of your South Africa and Netherlands Operations on a stand alone basis?

Gaurav Kumar: Our South Africa Operations recorded an EBIDTA of 6% and Netherlands Operations recorded an EBIDTA of 8%.

Bhagesh: And which is the best quarter for the Netherlands operation normally?

Gaurav Kumar: The best quarter really would be a little bit of Q2 and most Q3. Their best months are August, September, October, November, which is due to winter tyre sale.

Bhagesh: And what will be the capex in India, South Africa and Netherlands this year?

Gaurav Kumar: In Netherlands, there would only be maintenance capex. In South Africa, again given the economy, we don't have any major capital expenditure plans. There had been plans drawn up to increase the truck radial and passenger car radial capacity, but given the economic situation, they have been more or less put on hold for now.

In India, we are looking at a capex of Rs 9 billion this year, the large chunk of which, approximately Rs 7 billion would be in our Chennai greenfield. We are looking at expanding the truck radial capacity there rapidly, given the progression of radialisation in India. Rest of it is really small capexs into the OTR and other expansions at our Baroda plant.

Bhagesh: Coming to the domestic scenario, in truck radials there has been a ban on import of Chinese radials as of now, and the truck radial market is supposed to have grown quite sharply in Q1. So, can you share more details with us?

Gaurav Kumar: We don't have the exact numbers in terms of radial sales for all the domestic players, but the expected level of radialisation is at about 10% to 12%, which is a sharp increase from the 5% to 6% of the previous year. We are expecting this level to be at 25% in a couple of years. The constraint to a certain extent today is from a supply perspective since Indian players do not have adequate capacity as of now.

**Sahil Kedia,
Enam Securities:** A couple of quick questions. Can you just share with us the exact tonnage sales for the quarter please?

Gaurav Kumar: The sales tonnage for the quarter was 79,000 MT. This is for India operations.

Sahil Kedia: And Sir, you mentioned a consolidated EBITDA margin, I am sorry I missed that.

Gaurav Kumar: 12.7%.

Sahil Kedia: There has been a reduction in the net profit at the consolidated level. Could you please explain that?

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- Gaurav Kumar:** The so-called reduction in the net profit is entirely on account of the transaction expenses for the Netherlands Operations, which were booked into the intermediate entity.
- Sahil Kedia:** Sir, can you share the amount of the transaction expenses?
- Gaurav Kumar:** Approximately Rs 200 million.
- Supriya,
ICICI Securities:** You just mentioned in your opening remarks that there is an increase in the other expenses because some growth opportunities were pursued but did not materialise. Could you just elaborate on that? Secondly, what have been the rubber prices for the reported quarter and what is your view going forward?
- Gaurav Kumar:** On the other expenses, given the economic environment, we had multiple growth opportunities available. We pursued more than one opportunity, and finally based on various factors, strategic rationale, etc., settled in and closed only the Vredestein transaction. The cost on account of such other opportunities that we pursued and which did not fructify, resulted in such a large increase in other expenses. On the rubber front, the average price for the quarter was Rs 98/ kg in the reported quarter as compared to Rs 120/ kg for the same period last year.
- Supriya:** And what were the rubber prices in the March quarter of last financial year?
- Gaurav Kumar:** Rs 85/ kg.
- Supriya:** And what is your outlook going forward?
- Gaurav Kumar:** Present outlook is stable, but nobody today claims to be an expert on this.
- Chirag Shah,
Emkay Global:** Sir, on the raw material side, you have seen an absolute reduction in value terms on a Y-o-Y basis. Is it purely because of lower cost of inventory or is there some other adjustment lying over there?
- Gaurav Kumar:** No, it is essentially because the raw material prices have come down by 12%.
- Chirag Shah:** And what is the inventory that you are carrying? Generally you carry 21 days inventory, right?
- Gaurav Kumar:** Typically we carry about three weeks of raw material inventory.
- Chirag Shah:** So, going ahead, there would be increase in your raw material cost because currently basic rubber prices are roughly at Rs 95-98 range.
- Gaurav Kumar:** Which would mean a small increase. The prices may go up by 4-5%.
- Chirag Shah:** Is there any price reduction that has been passed on to the consumers?
- Gaurav Kumar:** No price changes have happened in the market in replacement or OEM segment.
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- Chirag Shah:** So, if I was just looking at EBITDA, the reported quarter recorded Rs 26 EBITDA/ kg. Is this run rate sustainable or because the mix was in favor of replacement, you achieved this and this kind of level is not sustainable?
- Gaurav Kumar:** If the mix changes, it will be adversely impacted because if you look at the revenue segmentation two years back for India, it was about 66-67% for replacement, that is when the OEM demand was booming and replacement was in low single digit growth. The current situation is OEM recording negative and replacement recording double digit growth. So, even if the volumes remain the same and the mix changes, the EBITDA/ kg would come down.
- Chirag Shah:** But in your assessment, do you expect significant shift over say next three-four quarters? What will be the current share of replacement demand?
- Gaurav Kumar:** In the current quarter, for India Operations, the replacement share is 76%.
- Deepika,
Capital Market:** What do you feel the margins would be going ahead for FY10?
- Gaurav Kumar:** We would not want to give out a guidance, but yes 16.5%, clearly is a high which we have not experienced over a decade. So, we would expect that on a full year level, it would come down a little, but that, of course, is impacted by various things. If the demand continues to be strong as it was in the first quarter and particularly from the replacement segment, there would be no pressure to pass on any price reductions. And if RMs (raw material) remain at this level, our margins would move up because we would not have the higher other expenses which have been there in this quarter.
- Deepika:** Can you just share with us what were the prices of NTCF and carbon black. And going ahead, where do you see carbon black and NTCF prices in the next quarter?
- Gaurav Kumar:** Nylon cord fabric was at Rs 170/ kg compared to Rs 175 in the same period last year and Rs 188 for March quarter last year. Carbon black was at Rs 42/ kg for the quarter compared to Rs 45 for the same period last year Rs 53 in March last year.
- Deepika:** And one more other question. We have a JV with BEML, right?
- Gaurav Kumar:** There is no JV with BEML. We have set up a captive capacity for them for OTR tyres, but it is entirely within the Apollo set up., the output of which would be supplied only to BEML as of now.
- Deepika:** But BEML also has this kind of partnership with our competitor. So how different is our product mix supplied to BEML when compared to the other player?
- Gaurav Kumar:** I would not know of the product mix of the other player, but I would expect it to be pretty similar. The reason essentially is that BEML instead of giving it out to one supplier have played it safe and given it out to multiple suppliers.
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- Deepika:** And when will the Chennai plant be coming on stream?
- Gaurav Kumar:** It would start commercial production towards the end of this year and then the capacity be ramped up for the truck radial tyres.
- Deepika:** Then what would be the capacity for Chennai at the start?
- Gaurav Kumar:** At the initial level, we were looking at 1100 tyres of truck-bus radials per day. And that is a capacity of about 65 MT. This has now been increased to 3000 tyres per day resulting in a capacity of 180 MT. And the passenger car radials would be about another 50 MT. The initial capacity which would come onstream is about 100-110 MT. That would increase to about 240 MT and then we would look to increase the truck radial capacity even further.
- Deepika:** I just missed out what was the EBITDA margin of South Africa and Netherlands Operations?
- Gaurav Kumar:** Dunlop was 6% and Netherlands was 8%.
- Mahantesh Sabarad, Centrum Broking:** What was your overall raw material cost for this quarter and how does it compare to the March quarter and the June quarter of last year?
- Gaurav Kumar:** This quarter the overall raw material price Rs 87/ kg compared to Rs 100 in the same period last year and Rs 93 for March quarter last year.
- Mahantesh Sabarad:** What would be the sales tonnage for same quarter last year.
- Gaurav Kumar:** 73,000 MT
- Mahantesh Sabarad:** What would be your consolidated debt right now?
- Gaurav Kumar:** I would not be able to talk of consolidated debt because we are not at liberty to talk about the debt in our Netherlands operations.
- Mahantesh Sabarad:** But that means the Netherlands transaction was an equity plus debt, and you paid only the equity portion to acquire it?
- Gaurav Kumar:** That's right.
- Mahantesh Sabarad:** On the raw material front, are there any significant imports that you are doing to mitigate the cost increases?
- Gaurav Kumar:** Depends from material to material. For example, in tyre cord fabric, bulk of it is imported. In rubber, depending on the price parity between the domestic rubber and import from overseas, we keep changing the mix. Usually, it has been about 90:10, but that has currently changed a little bit in favor of imports given that of late domestic prices have been significantly higher than the international prices. Carbon black is predominantly domestic.
- Mahantesh Sabarad:** You have been currently doing an EBIDTA of Rs 15/ kg. What would be the EBIDTA for radial tyres?
- Gaurav Kumar:** Exact figure would be difficult, but in general, radials would provide a higher margin, with plant level economies of scale. And that is the reason you see in most of the places where the mix is entirely radial, margins are

better. Critical would be to reach a capacity upwards of 200 MT per day. In the initial years, the margins would be lower because the plant begins with a non economical size capacity.

Mahantesh Sabarad: In your Netherlands Operations, what kind of sales are you looking at in FY10 and FY11?

Gaurav Kumar: If we look at the last few years, Vredestein has been growing at about 8% per annum on the topline. The current year for the European market is tough, so we would not be expecting a revenue growth. Even on a calendar year basis, they are running at levels similar to last year or 1% up, which, in the context of European market, is very good. There have been recent reports that a lot of government bodies, to provide a boost to the economy and automotive industry in general, have ordered a large number of passenger car vehicles. So, we would probably start seeing an upturn from the next year onwards.

Mahantesh Sabarad: But your Netherlands Operations is largely into luxury car tyre manufacturing.

Gaurav Kumar: Not luxury car tyre but the upper end on passenger car tyres, which is winter tyres or high speed tyres.

Mahantesh Sabarad: And their market share approximately in Europe?

Gaurav Kumar: They sell about 5 million tyres in Europe where the approximate market size is 300 million tyres, so roughly about 1.7%.

**Sahil Kedia,
Enam Securities:** You mentioned that you were looking at multiple transactions and Netherlands transaction actually was one of them. Just wanted to get your thoughts, are you currently also looking out for further acquisitions either in India or overseas?

Gaurav Kumar: We would always be open because opportunities like this keep coming once in a while and we remain open and alert if it makes sense to us. But on an immediate basis we would prefer to first consolidate this and then look at further acquisitions. However, if something comes up, we would definitely evaluate. There is nothing on the table at present.

Sahil Kedia: Can you just give me the breakup of replacement versus OEM revenue for the last quarter FY09 and on a Y-o-Y basis?

Gaurav Kumar: The replacement share for the reported quarter was 76% and OEM 17% compared to 74% and 20% in the same period last year

Sahil Kedia: And what was it in Q4 FY09?

Gaurav Kumar: Q4 FY09 was 74% replacement, 15% OEM and balance exports.

Vinay Shah,

Reliance Mutual Fund: Would like to know about the funding arrangement of the Netherlands acquisition in terms of how much will be from internal accrual and how much from debt?

Gaurav Kumar: I would not have the exact details.

Vinay Shah: Can I have the standalone debt and cash levels?

Gaurav Kumar: The standalone debt on India is Rs 7.5 billion and the cash in hand is Rs 2.2 billion.

Vinay Shah: And where we see the debt equity going forward?

Gaurav Kumar: Based on our expansion plans of Chennai and others, we expect to be around the 1 mark on debt equity by end of the year.

**Krudant,
Value Quest** Sir, what was the average cost of rubber in this quarter?

Gaurav Kumar: The average cost was Rs 98/ kg.

Krudant: Have you entered into any contracts for supply of rubber or do you buy from the spot market?

Gaurav Kumar: India is all spot market, but the overseas purchase that we do, would be a contract for a quarter.

Krudant: So, how much do you import?

Gaurav Kumar: The percentage keeps changing, probably would be at around 15-20% right now.

Krudant: Was there any growth in the commercial and passenger car segments in this quarter as against the last quarter?

Gaurav Kumar: The CV was flat vis-à-vis the previous quarter in terms of volume. Passenger cars, there was a growth of 4%. That is replacement, OEM, and exports, all put together.

**Saurabh,
BNP:** On the supply side, do you foresee that the MRF plant shutdown had a significant impact on the overall volumes for the industry and how do you see this going forward in terms of an overall supply situation?

Gaurav Kumar: It would have definitely had some impact, but not a significant impact as the overall capacity that was shut down was not significant, and also there was a certain amount of inventory being carried from the previous year given the earlier sluggishness in the market. The quarter also had the benefit of truck tyre imports from China coming down significantly.

Saurabh: You indicated that the replacement demand was roughly 10% growth, whereas if I just consider the ban on Chinese imports, that in turn would contribute roughly 10% to the overall growth. So, does that mean that the industry ex-Chinese tyres did not grow much?

Gaurav Kumar: It would have grown because if we look at the industry production numbers for April and May there is a growth of 5%. Given that exports

have not grown and OEM demand has been in the negative, there is growth in the industry which is coming from the replacement market.

Saurabh: So, probably with the overall economic activity seeing some positive movement in the recent months, we are a little more sanguine on growth going forward.

Gaurav Kumar: That's right.

Saurabh: And since the non-rubber part of your raw material really has a one-quarter lag in terms of crude price increases, the price increase in the second quarter would be quite sharp?

Gaurav Kumar: Our expectation is that there would not be a significant movement in raw material upwards in the current quarter.

Saurabh: If you can just broadly give us the amount of your overall raw material imports for the quarter, in terms of spend?

Gaurav Kumar: At a broad level, about one-third of our raw material spend is imported.

Saurabh: And we generally do not take any forward currency contracts on that?

Gaurav Kumar: That's a regular call taken. It is not a clear policy to have an open position at all times.

Saurabh: And it gets partially offset by our exports.

Gaurav Kumar: The policy which is very clear is that the foreign currency borrowing is completely hedged. However a monthly call is taken on the operational foreign currency position in terms of whether to take a cover or not.

Saurabh: And of the Rs 7.5 billion of standalone debt, how much is foreign currency?

Gaurav Kumar: Should be about Rs 2 billion.

Chirag Shah, Emkay Global: You had indicated an increase in other expenses because of certain opportunities pursued. What was the amount?

Gaurav Kumar: I would not be in a position to share the amounts in the other expenses, but a large chunk of the increase is coming from pursuit of growth opportunities.

Chirag Shah: But that would be a one-time kind of an event?

Gaurav Kumar: That is right.

Chirag Shah: So, your actual operating other expenditure is much more lower?

Gaurav Kumar: It is definitely lower. There have been increases on various counts. It is not as if the entire increase is on account of pursuit of opportunities.

Chirag Shah: What is your assessment of actual demand from the replacement market? Can we go back to a normal growth of 5-6% in the next two quarters or will it will take some more time for that to happen?

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- Gaurav Kumar:** Right now the demand growth is more than that, and as per current indications it is expected to continue.
- Chirag Shah:** No, I am assuming that a large portion of the 10% growth is coming from reduction in Chinese imports.
- Gaurav Kumar:** As I mentioned earlier, the industry in the month of April and May has grown by 5% in terms of production and this entire growth is in replacement as OEM growth is negative and there is nil growth in exports
- Chirag Shah:** And how is the order flow from the OEM? Do you have some firm indications coming out from their side, both on commercial vehicles as well as passenger car side?
- Gaurav Kumar:** There is very little of concern from the passenger car segment because that has seen a growth of upwards of 20%.
- Chirag Shah:** And how is it on the commercial vehicle side?
- Gaurav Kumar:** Commercial vehicle was down nearly 40% for the industry last year. There is some sign of an upturn in the current quarter, but a positive growth is expected from the second half which would also be because the second half was dismal last year.
- Chirag Shah:** So, we can expect that if the OEM share doesn't increase, you would register a strong performance in terms of operating margins provided the raw material costs stay where they are?
- Gaurav Kumar:** True, but on a longer term, you have got to recognise that a continuous slump in OEM demand is not good for us because it ultimately translates into replacement demand.
- Ambrish Mishra, MF Global:** Just wanted to get an idea on the fund raising that we did for the acquisition and by what time do we think that the impact of that fund raising would hit our books, because currently looking at the interest cost, it doesn't appear it has actually come into the books.
- Gaurav Kumar:** We would have raised the funds somewhere by early May because we paid it out on May 15. So, for nearly two months, that interest impact would definitely be there.
- Ambrish Mishra:** And can you share at what kind of cost we have raised the funds?
- Gaurav Kumar:** Would be at about 10%.
- Ambrish Mishra:** And it is a rupee loan?
- Gaurav Kumar:** It is a rupee loan.
- Ambrish Mishra:** If you can just give a broader view as to where do we see Apollo Tyres two years down the line? What kind of product mix, margin trend, size on a consolidated basis?
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- Gaurav Kumar:** In March 2011, we should be looking at revenue in the region of Rs 90 billion. However we need to keep in mind the fact that currency trends play a big role in overseas growth.
- Ambrish Mishra:** By what time frame do you think we will be able to stabilise the efforts in terms of domestic capex and acquisition integration.
- Gaurav Kumar:** Stability in terms of putting a brake on growth? Probably never. For the next two to three years, we would be in a rapid growth mode for India Operations given what is happening in the market on truck radialisation. We would ultimately look to take our Chennai truck radial capacity to 6000 tyres per day. It would be a rapid growth mode for the India Operations for the next two to three years.
- Our South Africa operations are completely integrated and are stable. There, we are not looking at any growth on capex given the kind of market outlook.
- In Netherlands, we should be through with various key integration plans within this year. It is a stable operation and given that it is located in Western Europe, it will not be able to undertake big expansions of capacity. We would really look to bring in benefits on synergies through outsourcing from India and South Africa.
- Ambrish Mishra:** And what would be the capacity utilisations at both these facilities?
- Gaurav Kumar:** Netherlands operations have been operating at anywhere between 90 to 95% capacity utilisation.
- Ambrish Mishra:** I was trying to understand in the recent say last one or two quarters, what kind of capacity utilisation have you seen there given the difficult time?
- Gaurav Kumar:** They have been at about 90%. And South Africa operations in this quarter has come down in terms of capacity utilisation to about 75%. Otherwise, it has been in the region of 85% to 90%.
- Karthik, Crisil:** What is your capacity utilisation at the India operation?
- Gaurav Kumar:** That would be close to 100% for this quarter.
- Kunal Bhatia, Dalal & Broacha:** How much of the domestic demand was being met by Chinese imports earlier and what is the situation at the moment?
- Gaurav Kumar:** If you look at prior to the license imposition, the import level of Chinese truck radials was at about 70,000 tyres per month. That dropped to around 15,000 tyres per month, post licensing requirement.
- Kunal Bhatia:** And sir, what would be the overall market size for truck radial?
- Gaurav Kumar:** The total replacement market for truck tyres is about 10 million tyres per annum. 10% of this would be radial

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- Kunal Bhatia:** What is your view on the demand coming in from the truck segment? You would be having a sense on what order flows you have for the M and HCV segment, so if you could just shed some light on that?
- Gaurav Kumar:** See, the overall outlook given for the year earlier was a flat growth vis-à-vis last year. The recent dialogue however indicates that there may be some growth, but most of it would start coming in from the second half onwards.
- Kunal Bhatia:** What would be the reason for sustainable growth, as anticipated, in the truck radial tyres?
- Gaurav Kumar:** Experiences from around the world, tell us that when truck radialisation starts accelerating at some point of time, it acts as a catalyst where there is a mass movement to switching to radials. It happened very rapidly in the case of cars. Once Maruti 800 shifted and put on a radial tyre, each one of us just assumed that we should buy only a radial tyre because that is good. However a trucker probably puts in far greater involvement and decision making when he buys a tyre. However, for the segments where the roads are good, he would have started seeing the benefits of radial tyres in terms of less fuel consumption or longer life and those are real tangible benefits for the trucker. These segments would witness an accelerated shift in the future. It would be far slower in places where the road conditions continue to be bad.
- Deb Banerjee,
ASK Investments:** What was the overall tonnage growth year-on-year this quarter?
- Gaurav Kumar:** 2%.
- Deb Banerjee:** And what was the growth in various product categories?
- Gaurav Kumar:** In truck it was basically flat and in passenger cars it was 15%.
- Deb Banerjee:** In recent newspaper reports there was some article regarding some hotel and IT parks setup in Kerala for an investment of Rs 10 billion. Any light on that?
- Gaurav Kumar:** That is an investment by a separate company which is PTL. It has no shareholding connection with Apollo Tyres.
- Bhagesh,
HDFC:** You said that the margins were 8% in Europe and 6% in South Africa and Rs 200 million was an exceptional item due to the consultancy cost in the Netherlands transaction. What was the PAT in the South African and the Netherlands unit?
- Gaurav Kumar:** South Africa would be a positive PAT and together they would be at break even levels.
- Vinay Shah,
Reliance Mutual Fund:** What was the average cost of borrowing this quarter?
- Gaurav Kumar:** For the fresh borrowings, it was around 10%. The previous borrowings would have continued as per their norms.

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- Male Speaker,
Jet Age Security:** Your raw material prices as a percentage of sales has come off by nearly 10% from around 69% to around 59%?
- Gaurav Kumar:** If you take the inventory impact, that is the decrease in inventory levels as compared to same period last year resulting in lower raw material consumption, it has come off from 64% to 59%. What you are looking at is only the consumption of raw material.
- Abhimanyu,
Avendis Capital:** What kind of margins do you expect in your European Operations?
- Gaurav Kumar:** Historically they have recorded better margins than Indian Operations. This year, given the European market conditions, they would be probably lower than us. But on a general basis, they have always recorded better margins. We would expect European margins to be upwards of double digit.
- Abhimanyu:** So, you expect an improvement in the second half for the Operations there in terms of margins?
- Gaurav Kumar:** That's correct. Even historically, Vredestein's their second half has always been better, given the sale of winter tyres.
- Ramnath
Subramaniam:** Thank you all of you for logging on to the call. Thanks Gaurav.
- Gaurav Kumar:** Thank you.
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