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Analyst / Investor Conference Call

Second Quarter of Financial Year 2009-10

Ramnath

Subramaniam:

Good afternoon all of you. On behalf of IDFC-SSKI Securities, I welcome you all to the Q2 FY10 post results earnings call of Apollo Tyres. I take this opportunity to welcome Gaurav Kumar, Group Head, Corporate Strategy and Finance who would run us through a brief introduction and talk about the result.

Gaurav Kumar:

Good afternoon everyone. Thanks for coming on to the call. To begin with, I will briefly talk about the three markets where we operate.

The Indian market has continued to see a strong replacement demand and in this current quarter we have seen a pickup in the OE segment also. While the passenger car OE segment has continued to remain strong, there has been a pickup in the truck OEM segment and we expect that to continue going forward. As per the industry data for five months, truck figures are extremely encouraging. The industry production for the domestic market is up 8% in truck and in the light commercial vehicles, it is up 14%. For the South African market where the first quarter results were quite depressed because of the challenging market situation, we have seen a pickup in the replacement demand and while OEM is still weak given the global situation, the signs are far more encouraging than they were at the end of last quarter.

Coming to our third recently added operations in Europe -- the market is still recovering. The replacement and OEM segments are in negative growth for the current year. However, our specific operation continues to do better than the market in terms of a flat revenue, compared to last year vis-à-vis a market which is negative by about 5% to 10%.

Moving on to the critical cost component which is raw material, it was significantly lower in this quarter compared to the same period last year. However, sequentially the raw material cost was up by 3% and in terms of looking ahead in the near future, the raw material cost is expected to increase by about 10% in the next quarter and hence would add a certain amount of pressure in terms of profitability for the industry.

Moving on to the consolidated results, the net sales for the quarter were Rs 20.5 bn, up 62% compared to the same period last year. 44% of which is on account of the inorganic growth contributed by the European Operation and the balance was on account of volume. The net margin was Rs 1.3 bn or 6.3%, significantly higher than the same period last year. The Indian Operations reported sales of Rs 12.2 bn maintaining the operating margin at 16.5%. The top line growth of 24% in the current quarter was driven entirely by volume and the net profit reported for the current quarter was 8.4%. South African Operations recorded net sales of Rs 2.9 bn. The EBIDTA touched a double digit mark compared to 6% last year and the net profit was about 4%. European Operations reported net sales of Rs 5.5 bn, flat vis-à-vis last year, an EBIDTA of 11%, and a net profit of 2%. That's all I have as an introduction. We would be happy to take your questions.

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- Supriya,
ICICI Securities:** You said that the sales growth was completely driven by volume growth. Could you just quantify the volume for the quarter. My second question is what was the rubber price for the quarter and going forward what is your expectation?
- Gaurav Kumar:** The sales quantity was 82,000 metric tons. The rubber price for the quarter was Rs 100/ kg. In terms of outlook going forward, we expect the prices to go up. While third quarter is typically the peak season and hence the outlook being given till about a week back was that rubber prices should soften, but as we speak, the rubber prices have crossed Rs 110/ kg. That is the basic price. So, we would expect the overall quarter prices to be definitely beyond the 110 mark.
- Supriya:** Okay. And the sales quantity for the corresponding quarter?
- Gaurav Kumar:** 66,000 metric tons.
- Supriya:** And how have been the other raw material prices like your synthetic rubber and carbon black?
- Gaurav Kumar:** Tyre cord fabric price for the quarter was Rs 180/ kg and carbon black was Rs 45.
- Sahil Kedia,
Enam Securities:** Can you throw some light as to why your interest cost is lower in this quarter? Have you repaid any debt?
- Gaurav Kumar:** Some of the older debt has been paid off. And most of the new debt is for the Chennai expansion, and since it is in the project phase, the interest cost has been capitalised and is not booked as a revenue expense. That is the reason for the drop.
- Sahil Kedia:** Is it possible for you to share with us the standalone debt figures please, at the end of the quarter?
- Gaurav Kumar:** The standalone net debt at the end of the quarter was Rs 6.6 bn.
- Sahil Kedia:** What is the kind of capacity that is coming on stream in Chennai since we are closer to the planned launch. What capacity are you looking at and do you expect the tonnage numbers that we are currently doing at about 80,000 metric tons to improve in the second half of the year?
- Gaurav Kumar:** No, Chennai will begin production in the last quarter of the year.
- Sahil Kedia:** So, it will have no impact on FY10?
- Gaurav Kumar:** That is right. The capacity really comes on stream from FY11, and the ultimate capacity in FY13 would be about 440 metric tons a day. Which in terms of annual capacity is about 150,000 metric tons. In FY11, about one-fourth of that capacity would probably be on stream on an average for the full year.
- Sahil Kedia:** In this quarter we have seen a sharp improvement as far as the subsidiary numbers are concerned. Just wanted to get some sort of an outlook because you are headed into Q3 which is apparently a good quarter as far
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as your Netherlands Operation's winter sales are concerned. So, is this revenue run rate and profitability likely to be maintained or would it be better?

Gaurav Kumar: Profit of our Netherlands Operations is driven by four good months which is August, September, October, and November. So, we would expect next quarter to be in line with the current quarter, of course depending on how much of snowfall happens in various parts of Europe. So, to a large extent, there is a seasonality impact and it is also driven very much by an early onset of winter, or how heavy the snowfall is. Given the present indications, winter is expected to be good this year and hence we expect the next quarter also to be good for Netherlands. South Africa, there is a clear pickup that has taken place and as of now, the signs are that the recovery would be slow. But if raw material prices remain where they are, we should be able to maintain performance.

**Deepika,
Capital Marketing:** What was NTCF price in the same quarter last year?

Gaurav Kumar: Rs 190/ kg.

Deepika: And how about carbon black?

Gaurav Kumar: It was at Rs 55/ kg in the same quarter last year.

Deepika: The anti-dumping duty in the US on Chinese imports, will this really impact Indian exports to the US?

Gaurav Kumar: The quantity of exports of tyres to the US from Indian players is very small. We ourselves do not exports to the US. Hence the impact of anti-dumping on Chinese Tyres will be negligible for us

Deepika: Don't you think it is the right time for you to enter the US market as 35% anti-dumping could have a huge impact?

Gaurav Kumar: Two things -- in terms of being a global player, we are still at the initial stages. Europe is a more focused market for us for various reasons. Economically also it makes greater sense for us to be in Europe. We do operate in the US in a small way through our Netherlands Operations but that is only about 2 to 3% of the revenues of the European Operations. For Indian Operations, even if we wanted to, today we don't have the capacity to explore the US markets given the strong demand in the domestic market. For us the domestic market remain a priority for Indian manufacturing operations.

**Chirag Shah,
Emkay Global:** What is the general lag impact for you for crude-related raw materials? Is it right to assume the lag impact is a quarter or is it less than that?

Gaurav Kumar: No, it is not less than a quarter. Sometimes it could be even delayed up to six months.

Chirag Shah: I was just looking at the tonnage sold number that you shared. I observed that on a Q-on-Q basis your realisations per ton have actually dipped marginally. Is it because you have indicated a good pickup in truck and bus segment and realisations per ton have marginally dropped by 0.4% because of this, or is there some other reason?

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- Gaurav Kumar:** No, essentially there would be a small marginal drop because the share of OEs has gone up and that is the only reason. There have been no price changes which have taken place.
- Saurabh Das, Sundaram
BNP Paribas:** Could you share the gross block of VBBV if possible?
- Gaurav Kumar:** I would not be able to talk about the balance sheet of our Netherlands Operations due to regulatory constraints.
- Saurabh Das:** Could you share the first quarter numbers of VBBV, I know that you have acquired it from May 15th onwards, but if you can just give an idea of the 45 days in the first quarter?
- Gaurav Kumar:** The 45 days results were Rs 2 bn of sales and EBIDTA of 8% and a breakeven at net profit level.
- Rohan,
Anand Rathi:** I just wanted to know the capacity utilisation for the quarter.
- Gaurav Kumar:** Capacity utilisation at India is almost 100%. Netherlands would be in the 90 to 95% level and South Africa would be around 85 to 90% level.
- Rohan:** What is the percentage of raw materials imported in the quarter, if you have that figure handy?
- Gaurav Kumar:** I don't have that figure handy, but typically around one-third to 40% of raw materials is imported.
- Rohan:** And we are restricted by licenses basically on this?
- Gaurav Kumar:** No, there is no restriction by licenses. Licenses only help you to lower the cost. If you are ready to pay the price and the duty, there is no restriction on importing any of these raw materials.
- Saurabh Das, Sundaram
BNP Paribas:** The industry typically reverts to 14 to 15 odd EBIDTA margins. So just wanted to get a sense as to how quickly do we see those margins coming back in this year? You mentioned 10% increase in raw material cost and the price hikes that you have taken is about 3% from October.
- Gaurav Kumar:** EBIDTA at 16.5% for the industry has not happened historically at least as far back as we have analysed the results. And hence as an industry we would be very happy if we are able to operate at the 13-14% level. Our broad analysis shows that if we are at about 11% odd mark, our return ratios and our ability to generate cash flows is decent. However given the investments required in the radial plant, we would probably want the margins at 12 to 13% level on a consistent basis to ensure decent returns.
- Saurabh Das:** And also correlated to this is the supply-demand scenario in the industry. Of late, I have been hearing of Dunlop again starting its Chennai operations and Kesoram has already started its operations. So, do you see pricing power to continue with the manufacturers going forward?
- Gaurav Kumar:** Well, it would not be as good as the second quarter. As you are correctly saying, Dunlop is starting its plant. Modi has begun its operation. Birla is adding capacity in truck radial, which will take some time. But yes,

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- probably in Quarter 3, even if demand remains where it is, there could be some pressure due to increased supply.
- Mahantesh Sabarad, Centrum:** Dollar is now down to Rs 46. Does that encourage more imports of tyres by traders, and hence will this result in a pricing pressure for you?
- Gaurav Kumar:** Well, it has two things: (a) For us on an immediate basis, given the fact that we are net importers, a strong rupee is beneficial because it immediately provides relief on more than one-third of our raw material bill and that is on the positive side. (b) It does encourage imports coming into the country to a certain extent and adds to the supplies, but given the quantity of imports that we have seen so far, we are happier with a stronger rupee. Also given the fact that we are in a project phase where a significant component of machinery would be imported, the company would be happy with a strong than a weak rupee.
- Mahantesh Sabarad:** I understand that the growth in the replacement demand would be in the range of 25% mark for the first half of the year. If the first half has been so strong as far as replacement tonnage growth is concerned, do you think the second half will sustain that kind of growth rate? You are already at peak capacity right now if I am correct. So, will it mean that in the second half you will have just about a 7-8% kind of normalised growth?
- Gaurav Kumar:** Yes, you are right in saying that the replacement demand has been stronger and the final numbers that are resulting is from a weaker OEM demand. In the second quarter, while the replacement demand growth may not be at the same level as first half, OEM demand is expected to pick up. Also most of the the second half of last year, that is October to January period was not good for either OEM or replacement, and hence we expect at least a double digit growth in the second half coming from stronger OEM growth and decent replacement growth.
- Mahantesh Sabarad:** Are you negotiating with the OEs for possible price increases? You typically have it with a retrospective impact, so what is the status of that negotiation and how much have you already provided if you at all make any provisions in your sales?
- Gaurav Kumar:** Presently in the case of passenger cars, we are at an advanced stage and with one or two OEMs, it is near finalisation, but is not yet signed off.
- Mahantesh Sabarad:** But raw material is actually decreasing on a year-on-year basis?
- Gaurav Kumar:** I meant sequential increase in raw material prices which is expected to be 10%.
- Vinay Shah**
Reliance Mutual Fund: If you can please share the consolidated debt and cash levels?
- Gaurav Kumar:** Consolidated debt we will not be able to share given the constraint we have on the Netherlands Operations.
- Sahil Kedia**
Enam Securities: The price increase in October, is this only in truck and bus radials? What is the exact nature of this price increase?
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- Gaurav Kumar:** It is across the various categories in the replacement market and is about 3% overall. It may be varying a little bit from product category to product category.
- Sahil Kedia:** And Sir, blended price increase would be about 2-2.5%?
- Gaurav Kumar:** That is right.
- Sahil Kedia:** Just wanted to do a check in terms of the imports from China. While we understand that there has been a ban and you now need licenses to import, interaction is suggesting that, there are new licenses being awarded by the government and imports from China are seeing an uptake because of the strong demand. Just wanted to get your sense on that Sir?
- Gaurav Kumar:** Your information is correct. As time has gone by, people have managed to get licenses and there is a pickup now. How sustainable this would be is something to be seen since each time the importer needs to get a fresh license. This is obviously a more cumbersome procedure than simply placing an order.
- Sahil Kedia:** Do you have the data on the imports market share? How much of the percentage would be imported from China currently?
- Gaurav Kumar:** Well, it had gone up to as high as about 9% last year. But post licensing in the current year, it has dipped to below 5%. I don't have the numbers for the last two months of August and September.
- Chirag Shah, Emkay Global:** My question is on the export side. I came across some article which says that Chinese players are now aggressively looking at the developing markets due to the ban being put on imports in the US. How big is this threat as per your assessment, because that would put some pricing pressure on exports from India, as well as your South African Operations?
- Gaurav Kumar:** One, the ban or the anti-dumping duty that has been imposed on Chinese tyres is in the passenger car segment. So, it is not impacting the truck market. Also a passenger car tyre customer is a little more conscious of the brand he or she is buying. It is a personal use item and therefore the brand element comes in. You wouldn't want somebody to look at your expensive car and comment on being stingy on the tyre on it. Even in India, the bulk of the passenger car tyre imports which are coming in today are high on the brand hierarchy. We therefore do not see it as a significant issue.
- Chirag Shah:** You are operating at almost 100% levels at 82,000 metric tons. For the next two quarters, there should not be much of a pressure in terms of growth because of low base, but as you enter FY11, how should we look at this tonnage number? What is the expansion that is likely to happen? Could you break it down slightly, in more micro terms of time and segment horizons. That would be really helpful.
- Gaurav Kumar:** See, one thing to be kept in mind is that nobody is going to be adding cross-ply or bias capacity because of the impending radialisation in the truck segment and hence there would be a constraint on the bias supply. While the numbers have continued to grow, there is a bit of a release valve in terms of a certain percentage of exports that the industry
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- undertakes. And even in the current year, exports have gone down to service the domestic market and that will continue in the next year if cross-ply demand continues to grow. Coming to the radial side, we are adding capacity. We would add about 100 to 110 metric tons per day over FY11 and that would be enough to service the radial growth of the Indian tyre market.
- Chirag Shah:** But this 100 metric tons per day is the annualised capacity or it is the operational capacity for the full year?
- Gaurav Kumar:** This is average for the full year. It will keep increasing every quarter. By March 2011, we would be at a much higher capacity.
- Sachin,
Lucky Securities:** Hi Sir. This is Sachin here. If you could just update us in terms of the Chennai plant. What is the total capex for the initial stage and approximately how much of that would have been spent by end of September?
- Gaurav Kumar:** The capex plan for the current year is about Rs 7 to 8 bn. I would not have a figure as to what has been spent as of September.
- Sachin:** Okay. And what is the total figure for Chennai phase I?
- Gaurav Kumar:** Well, we have sort of merged in all the phases, so we would not know where phase I ends and where phase II begins. We are looking at a Rs 20 bn project which would be spent by March 2012.
- Sachin:** And any update in terms of the capex that you could incur in FY11?
- Gaurav Kumar:** That number as of now is expected to be Rs 8 bn. By the end of this year which is March 2010, we would have spent about Rs 10 bn. And the balance Rs 10 bn would be spent over FY11 and FY12.
- Sachin:** And if you could give some sort of a roadmap in terms of the ramp-up that you see at the Chennai plant?
- Gaurav Kumar:** Next year, the average capacity as I mentioned would be 100 metric tons plus per day. FY12 we would be operating at at 200+ and FY13, we would be more or less at 400 metric tons.
- Nidhi Kanakia,
Marwari Shares:** I am Nidhi Kanakia from Marwadi Shares & Finance Limited. I just wanted to know what is the top line growth you are expecting for FY10 and FY11 for your overseas operations?
- Gaurav Kumar:** Well, FY11 the budgets are still be firmed up, so I would not be able to comment on top line growth now and that would also depend on market conditions. For the current year, we would expect the European Operations to be flat. Dunlop would probably have a slight decline vis-à-vis last year in terms of revenue.
- Chaitanya Adesara,
Sharekhan:** Our average natural rubber prices for the quarter were Rs 100/ kg. What was the same for Q2 FY09?
- Gaurav Kumar:** It was Rs 140.

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- Chaitanya Adesara:** What is the gross debt on books as on September 30, 2009?
- Gaurav Kumar:** Rs 9 bn.
- Kaushal,
Religare Capital:** Could you just tell me the debt on the books for South African Operation?
- Gaurav Kumar:** Rs 1.7 bn.
- Deb Banerjee,
ASK Investments:** What was the tonnage production in Q1 this year?
- Gaurav Kumar:** 78,000 metric tons.
- Mahantesh Sabarad,
Centrum:** When I look at your other expenses, they have been at around 18 to 19% of the sales. What would be the chief breakup of these other expenses in broad two or three items and how are those costs behaving for you?
- Gaurav Kumar:** The biggest component in that would be the selling and distribution expenses and that has gone up. It would include plant overheads like conversion cost, head office expenses and all other administrative expenses.
- Mahantesh Sabarad:** How about your expenses on plant overheads? The capacity has been almost 100% for the first and second quarter. Is there an increase that you are seeing on any account or normally would it be static?
- Gaurav Kumar:** No, there are usual increases on account of inflationary pressures and in some cases, for example, in furnace oil, increase has been double that of usual items. So, there are various increases that are taking place at the plant level.
- Mahantesh Sabarad:** So, what would you suggest should be the guidance for the second half in terms of the level of expenses?
- Gaurav Kumar:** Should remain at the same level in absolute terms.
- Naveen,
Dolat Capital:** Just wanted to get some idea on how radialisation is panning out in the truck and bus segment currently, what would be the levels in the next one or two years?
- Gaurav Kumar:** Current year, radialisation is at 10% -- same as last year. We expect the level to increase from the current 10% to about 25% in the next two to three years.
- Naveen:** You also mentioned that in Netherlands our current utilisation is around 90 to 95%. Wanted to know if you have any capex plans for Netherlands Operations in the next year?
- Gaurav Kumar:** No. Both in terms of space available and the geography which is a high cost one, it would not incur any growth capex. The capex that it incurs usually is for modernization and upgradation of its plant. Thee growth for

Netherlands Operations will be taken care of by outsourcing tyres to South Africa and India which then also provides greater synergy possibility.

**Nidhi Kanakia,
Marwari Shares:** Could you give me the other income breakup? Why has it increased?

Gaurav Kumar: The increase is on account of tax refund.

Moderator: Thank you very much ma'am. At this moment, if there are no further questions from the participants. I would like to hand over the floor back to Mr Ramnath for final remarks.

**Ramnath
Subramaniam:** Thanks to all of you for logging on to the call. Thanks Gaurav and all the best for the year.

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