Apollo Tyres Ltd
Quarter Three Earnings Conference Call – Financial Year 2009
January 20, 2009

Moderator: Good afternoon ladies and gentlemen. I am Priyanka, the moderator for this conference. Welcome to the Apollo Tyres Post Results Conference Call hosted by IDFC-SSKI Securities Limited. For the duration of the presentation, all participants' lines will be in the listen-only mode. I will be standing by for the question and answer session. I would now like to handover to Mr S Ramnath. Thank you and over to you Sir.

S Ramnath IDFC-SSKI: Good evening to all of you. On behalf of IDFC-SSKI, I welcome you all to the Q3 FY09 results conference call of Apollo Tyres. I also take this opportunity to welcome Mr Salil Gupta, CFO; and Mr Satish Mahajan, Head, Corporate Finance. Thank you very much Sir for coming in. I would also like to welcome Mr Amit Jhaveri and Arindam Chakrabarti who are also representing the company. Sir, can I request you to begin with a brief on the overall performance, and then, we will start the Q&A session.

Salil Gupta: Thank you Ramnath.

S Ramnath: Thank you Sir.

Salil Gupta: Good afternoon everybody. We held our Audit Committee and Board Meeting yesterday where the Q3 results were approved. I will begin with a brief overview about the performance of the company in the quarter gone by and also about the expectations of performance in Quarter 4, post which we would welcome any questions that the audience might have.

In the current quarter, there's been a demand slowdown, particularly from the OE segment and the rupee-dollar exchange rate continues to remain unfavourable. Over and above that, we have taken a hit of about Rs 140 million on account of reduction in excise duty by 4%, that we passed on to customers. Having said that, we continued to perform better than competition and we should be in a better position at the end of Q4, when the entire impact of raw material price corrections would come into effect.

Now, coming specifically to some numbers for Q3 and YTD Dec 09. Net sales for Q3 at Rs 9033 mn saw a drop of about 7% from the corresponding quarter last year, whereas cumulative net sales up to December 2008 at Rs 29599 mn reflects a growth of 10% over the corresponding period last year.

Operating profit numbers for the quarter at Rs 536 mn saw a drop of 59% over the corresponding quarter of last year, and net profit at Rs 55 mn, by 91% over the corresponding quarter of last year. However, on a YTD basis, the operating profit is Rs 2.1 billion, 38% less over the corresponding period of the last year. The net profit is Rs 619 mn, a drop of 61% over the corresponding period of the last year. We expect a better Q4 with the impact of lower raw material prices, on the condition that demand continues to improve.

Some of the significant highlights of Q3: Our plant in Kalamassery, Cochin, has been under a lockout since December 6. We are unable to get workers to agree to higher production and efficiency norms. A substantial decline in demand from the OE segment led to some production cuts, at our plants in Limda, Baroda and Perambra, Cochin, working a 5-day week since the first week of December 2008.

On the raw material front, the overall raw material cost for the quarter was Rs 115/kg an increase of 35% over the corresponding quarter of the previous year.

During Q1 and Q2 we had increased prices by 12% due to rising raw material costs. With a fall in RM prices, this month we have decreased prices by 3 to 5%, on top of the CENVAT reduction in December. On the demand front, there are a couple of positives that I must mention. One is that the import of truck-bus bias tyres continues to be under anti-dumping duty. Import of truck-bus radial tyres has been brought under the restricted list by the Government of India. There is support from the Government for imposition of safeguard duty on import of passenger car radials and truck bus radials, particularly from China. If the safeguard duty were to be imposed, it would be a welcome development for the domestic tyre manufacturers.

Going forward, because of decline in internal accruals due of Q2 & Q3 performance, we would review our Capex plans on a continuous basis. Currently, our expansion plans, both at our Chennai greenfield and at Baroda are on track.

I would now hand over the floor to my colleagues. We will take specific questions, so please mention your name and the company that you represent, and we shall be happy to take any specific issues that you might want to be addressed. Thank you.

Moderator: Thank you very much Sir. We will now begin the Q&A interactive session. First in line, we have Siddharth Shah from JM Financial.

Siddharth Shah JM Financial: Sir, firstly, can you give me the volume degrowth that has taken place in Q3?

Salil Gupta: In the Truck category, Institutional Sales has seen a huge drop of 71% combined with a slowing down in Replacement and Exports. For Light Truck, Institutional Sales fell the most – by 40%. In Passenger Radials, we have grown by 11% in the Replacement segment, with Institutional seeing a smaller drop of 9%.

However, on a YTD basis in the replacement market, we are nearly equal to our previous performance on Truck, up 7% on Farm, up 2% in Light Truck and up 19% on Passenger Vehicle.

Siddharth Shah: Sir, what is the outlook for the next quarter in terms of volumes? What do you expect?

Salil Gupta: Q4 as I mentioned, we could see a significant improvement in our volume numbers given the government incentives in place, the imposition of a possible safeguard duty, a demand growth in the OE and replacement segments.

Siddharth Shah: So do you expect overall sales to be better than this quarter?

Salil Gupta: Definitely.

Siddharth Shah: I was just wondering whether it would not even match the first quarter performance.

Satish Mahajan: It may not match, but it will be somewhat close.

Salil Gupta: The concern area continues to remain on whether we will see a revival in the replacement and the OE markets, after liquidating accumulated stocks.

Siddharth Shah: On the RM index, if you could give me the last four index numbers for the last four quarters?

Salil Gupta: If we take the base at 100 for Q1 & Q2 07-08, Q4 08 is 105, Q1 09 is 118, Q2 09 is 138, and Q3 09 is 135.

Siddharth Shah: Sir, if you could just break up the average costs of all the raw materials for this quarter?

Satish Mahajan: We have natural rubber at Rs 110/kg, fabric gray at Rs 200/kg and carbon black at Rs 60/kg. These are the three major items which constitute our raw material

Siddharth Shah: Do you expect a certain amount of discounting to take place amongst the tyre manufacturers in the next few quarters?

Satish Mahajan: In the current quarter, prices have been dropped by 3% to 5%. Unless demand improves significantly, there might be a tendency towards discounting amongst competitors.

Siddharth Shah: Sir, lastly on Dunlop, if you could break up the volumes and the outlook on that.

Salil Gupta: The Dunlop numbers are like this. The net sales for Dunlop on a standalone basis for the quarter was Rs 2.1 billion, a decline of 17% over the previous year. The operating profit has seen a drop of 58% at Rs 189 mn. Net profit is at Rs 30 million, which is a drop of 86% over the corresponding quarter last year.

Siddharth Shah: Thank you Sir. If I have any other questions, I will get back.

Moderator: Thank you very much Sir.

Aniket Matre: Hello. This is Aniket here. May I please request participants to please restrict themselves to one question at the initial round?

Moderator: Thank you very much Sir. Next in line, we have J Radhakrishnan from IIFL. Over to you Sir.

J Radhakrishnan India Infoline: Good afternoon Sir. Just wanted to know on tonnage basis, can you tell us what were the volumes?

Salil Gupta: The total sale in metric tons for the quarter is 59,000 of which domestic sales is 50,000 mt.

J Radhakrishnan: Sir, I would like to know how replacement market is performing in the last two to three months.

Satish Mahajan: Replacement passenger radial is doing alright. We have grown by 11% in the current quarter. In the other segments we have seen a drop in volumes.

J Radhakrishnan: Now, at least in the replacement market, will it start growing, maybe from this quarter?

Salil Gupta: We still have to see the impact of reduction in interest rates, high depreciation, fall in inflation etc and the impact of low cost imports from China.

J Radhakrishnan: Sir, are Chinese products now also available at around 20% to 30% discount, or has this discount narrowed?

Satish Mahajan: Some correction has happened because of the rupee-dollar parity. Because of the 25% currency movement, the 20% discount has now reduced. When the rupee was at 40 against the dollar, then the discount was 20 to 25%. Now the rupee has depreciated to 48 which is down by 20%, the gap has been bridged somewhat.

J Radhakrishnan: Going forward, can we expect our prices to be narrowing compared to Chinese imports or how is it looking?

Satish Mahajan: If the parity continues to remain at this level, we feel that Chinese tyres may not be as attractive as it used to be. But it is also true that there is always a market for cheaper tyres.

J Radhakrishnan: On the Capex front, I wanted to know whether there is any change in the amount which we are planning to spend in FY09 and FY10.

Salil Gupta: As of now, for the nine-month period ending December, we have expended close to Rs 3 billion. Going forward, we shall evaluate our Capex plans as and when the need arises depending on the revision of the demand projections, the overall market scenario, access to funds, the availability of internal accruals.

J Radhakrishnan: So, maybe this year, we may end with around Rs 3.5 billion of Capex or something like that?

Satish Mahajan: We have spent about Rs 2880 million and as of now we shall spend another Rs 2 billion in the current quarter.

J Radhakrishnan: Out of this Rs 2880 million, how much may be towards Baroda and how much may be towards Chennai Sir?

Satish Mahajan: Out of this Rs 300 to 400 million is on the OTR project in Baroda and Rs 1250 million towards the Chennai project. The balance is for Baroda.

J Radhakrishnan: When is this OTR Capex expected to be over?

Salil Gupta: The OTR project is to be funded by a contribution of Rs 1 billion from Bharat Earth Movers. We are waiting for the funds to come in. We have placed the orders and started with plant building. We expect this to be rolled out some time in Q2 FY09-10.

J Radhakrishnan: Second quarter of 09-10, and when is our Chennai plant expected to start now?

Satish Mahajan: Chennai is end of FY10.

J Radhakrishnan: 2010, and we are going with initial TPD of 19 or maybe there is some change in that?

Satish Mahajan: We are reviewing the Capex and are spending the money on the mother equipment. We have reduced the Capex from Rs 10750 to Rs 9500 mn, and the tonnage will be 192MT/day.

J Radhakrishnan: Yeah, that is the total, but we had some phases in that. In the initial phase, we were expected to start with around with Rs 1000 mn or have I wrongly taken something.

Salil Gupta: No, that is a two-year project cost.

J Radhakrishnan: Okay. Sir, can you please tell me the cash position as on 31st December 2008.

Satish Mahajan: Rs 7 billion was the net debt, and Rs 1.2 billion is the cash and bank balances.

J Radhakrishnan: Thanks sir. That is all from me. Thank you.

Moderator: Thank you very much Sir. Participants are requested to ask only one question at the initial round, and then come back for the follow-up questions. Next in line, we have Vaishali from Angel Broking. Over to you, Madam.

Vaishali Angel Broking: Good afternoon Sir. Just one question. What is the capacity utilisation level at present?

Salil Gupta: In October 2008 capacity utilisation was 94%, for November it was 81% and average for the quarter would be about 80%.

Vaishali: Okay, so in peak time, you can operate as much as at 100%, is it?

Salil Gupta: We have the potential to be there.

Vaishali: So, what is the threshold limit you are setting up that you will continue with the Capx plans, going forward?

Satish Mahajan: We are planning in Chennai mostly TBR which is different from these capacities and also OTR at Baroda which is separate.

Vaishali: So, the brownfield, nothing is there right now?

Satish Mahajan: There will be some balancing of capacities in our existing plants.

Vaishali: And just one question on the pricing front. You are planning that Q4 will be better but there is a price war which is going on in the market. So you are planning to reduce your product prices in Q4 or offer a discount because the competitors are offering discounts.

Salil Gupta: We have already announced a price reduction between 3% to 5% in the first week of January 2009.

Vaishali: Okay. So that is matching with the competitors or it is still at a higher side?

Salil Gupta: It is in parity with our closest competitor.

Vaishali: Thank you Sir.

Moderator: Thank you very much Madam. Next in line, we have Vineeth from PINC Research. Over to you Sir.

Vineeth PINC Research: My question is that you have given Rs 8204 million as the total debt – is it consolidated level or only at Apollo?

Satish Mahajan: Standalone basis.

Vineeth: What would the consolidated levels be Sir?

Satish Mahajan: Consolidated levels should be around Rs 10.6 billion.

Vineeth: Can you just give gross block situation at consolidated level?

Satish Mahajan: Standalone basis is Rs 16 billion as on December 31, 2008. We also have a work-in-progress of Rs 3.5 billion. Rs 4 billion should be the gross block in Dunlop.

Vineeth: Sir, as we are near the end of FY09, what would we expect for FY10? Do we consider that volume would be around 10% to 15% down from this situation?

Satish Mahajan: Actually it is very difficult to take a call on that right now. There could be growth since Q3 was the worst quarter. You may have a lower base and therefore may show some growth in the next year.

Vineeth: Okay. Thank you Sir.

Moderator: Thank you very much. Next in line, we have Chirag Shah from MK Global. Over to you Sir.

Chirag Shah MK Global: Good afternoon everybody. My question is: One, how do you see the cost basis coming from the OEMs? Means there have been initial indications and what kind of pass through have been made or are likely to be made in this particular quarter?

Satish Mahajan: We have not considered any reduction in the OE segment yet.

Chirag Shah: But there must be demands. What I am trying to understand is there must be pressure on you.

Salil Gupta: There is tremendous pressure from the OEs to reduce prices. Even with reduced prices it would not have a significant impact on my bottom line since the volume of OE sales is reduced.

Moderator: Thank you very much Sir. Next in line, we have Sahil Kedia from Enam Securities. Over to you Sir.

Sahil Kedia
Enam Securities: Sir, just wanted some clarity on the working capital situation currently, if you can shed some light on that and what is the outlook on that please?

Salil Gupta: On the working capital side, we were under some pressure in Q3 because of accumulated inventory positions as compared to previous quarters because of two counts; One is the unsold inventory on finished goods because there was a sudden collapse of the demand, raw materials which were already in pipeline, these were high-cost raw materials which could not be converted and sold. This also led to increase in the inventory position. It definitely impacted on the working capital position.

Sahil Kedia: Sir, can you quantify in terms of what was the total working capital outstanding.

Satish Mahajan: When we are saying working capital pressures, let me also clarify that we are operating on a cash basis and 80% of our sales is on cash basis. Relatively, we are slightly higher in terms of inventory, but there is no pressure on the working capital cash flow side.

Sahil Kedia: Okay Sir. If you can just answer in terms of what would be the current inventory level, either in days or in metric tons?

Satish Mahajan: We have a raw material inventory of 20 days. Finished goods is higher than that.

Sahil Kedia: Alright Sir. Thank you so much.

Moderator: Thank you very much Sir. Next in line, we have Abhijit from Kotak Mahindra Mutual Funds. Over to you Sir.

Abhijit
Kotak Mahindra MF: Hello, good evening Sir.

Salil Gupta: Good evening.

Abhijit: I wanted to know about tonnage sales. Can you also mention about the production in terms of tonnage for three months and nine months?

Salil Gupta: Production for Apollo Tyres on a standalone basis for the quarter is 64,000 MT and for YTD production tonnage total is 2,10,000.

Abhijit: Okay, so you are carrying some excess inventory, I would guess because sales is lower by around 8,000 MT.

Salil Gupta: Yes.

Abhijit: Thank you very much Sir.

Moderator: Thank you very much Sir. Next in line, we have Bhagesh from HDFC. Over to you Sir.

Bhagesh HDFC: Good afternoon Mr Mahajan, this is Bhagesh from HDFC. This is regarding the tax policy in Q3, your tax on PBT looks to be 51% so can you just comment on this?

Salil Gupta: Bhagesh, if you see the quarterly results, the increase in tax position is essentially on account of the deferred tax provision. My current tax percentage is in line with my previous history – between 27% to 29% -- but what has happened is that as a consequence of the drop in profit on a quarter-on-quarter basis, the deferred tax which was actually an absolute number now looks inflated in percentage terms. If you look at the tax of 42% you are talking about on a cumulative basis, it is essentially on account of higher deferred tax provision because of timing differences as a result of the Capex and depreciation.

Bhagesh: Okay Sir, thank you.

Moderator: Thank you very much Sir. Next in line, we have Mr Dewan from Capital Markets. Over to you Sir.

Dewan Capital Markets: Good afternoon Sir. The company has reported 37% rise in exports, would you like to give any guidance for the current year in regard to exports?

Satish Mahajan: Actually, the 36% growth is mainly because of rupee depreciation. 25% of the increase is because of the rupee depreciation against the dollar. We have a business model where 75% of our revenue is from replacement market. We continue to have exports of 10% to 12%. If the rupee appreciates, this 10% to 12% will go to 8%, if it depreciates, it will go to 14% to 15%.

Dewan: Okay. Sir, can you just give me the raw material figures. I just missed out the prices.

Satish Mahajan: The raw material prices in the present quarter was more or less similar to the previous quarter at Rs 115/kg. It was Rs 85/kg in the corresponding quarter last year. We expect the prices to go down to the mid-90s/kg in the current quarter.

Dewan: Okay, can you just give me the break up of the natural rubber, synthetic rubber and tyre cord?

Satish Mahajan: For the third quarter natural rubber is was at Rs 110/kg, fabric, which is nylon at Rs 200/kg and carbon black is at Rs 60/kg.

Dewan: Okay sir, and are they contracted on a yearly basis?

Satish Mahajan: Rubber is on a daily basis and others on one month contract.

Dewan: One month contract. So, the price benefit will come in Q4.

Satish Mahajan: On the petroleum related products the benefit will appear in Q4, however on the rubber products, it is already there. We have certain inventory and imports. We are buying at current prices now, or less than the current prices.

Dewan: Thanks a lot Sir.

Moderator: Thank you very much Sir. Next in line, we have Mr Saurabh Dhar from Sundaram Paribas. Over to you Sir.

Saurabh Dhar Sundaram Paribas: Good evening Sir. Most of my questions have been answered. Just a follow up on the pricing, the 3% to 5% reduction which we took in this quarter is that over and above the excise duty?

Salil Gupta: That is right.

Saurabh Dhar: Okay, and since we said that the focus on fourth quarter would be retaining market shares, so in that case, just at the cost of repetition, the pricing per ton would see a downward trend of around 5 to 6% in this quarter?

Salil Gupta: We have taken a 3 to 5% price cut after Q3. Beyond that, it is difficult to say as of now what might be the extent of further discounts that we may be constrained to pass on.

Saurabh Dhar: Right, and on the debt side, you indicated that you have a Rs 8204 million standalone debt. Of that, what would be the working capital debt?

Satish Mahajan: Working capital is around Rs 6 billion.

Saurabh Dhar: Rs 6 billion, and how has that changed quarter-on-quarter?

Satish Mahajan: For 31st March 2008, it was Rs 3 billion, and presently, we have Rs 6 billion.

Saurabh Dhar: Okay, and given the reduction in the raw materials, you would expect the working capital to come down in the fourth quarter?

Satish Mahajan: We are expecting inventories to significantly drop on account of two factors – we are consciously monitoring the working capital on a weekly basis and raw material is already corrected in terms of inventory and we will have only 14 to 15 days of inventory by the year end. As the market is going down, and when we are having a recession, and there is no point in holding inventory, and the same holds true for the finished goods. As far as raw materials are concerned, we are alright. We expect to clean up a lot of finished goods inventory and working capital cycle in the current quarter.

Saurabh Dhar: Okay, and finally on natural rubber sourcing, almost all the natural rubber is sourced within India or imported?

Satish Mahajan: Yes 85 to 90% is from Kerala. It should go to 100% because Kerala is cheaper and there is no point of importing right now when the domestic prices are cheaper.

Saurabh Dhar: Does the exchange rate have any bearing on domestic natural rubber prices?

Satish Mahajan: Imported rubber is priced at Rs 5 to 7 higher than domestic rubber, so then there is a tendency to buy domestically.

Saurabh Dhar: So, essentially currency will not have any impact on your prices?

Satish Mahajan: 85-90% of rubber is bought locally and only in respect of 10-15% of imported rubber the currency will have an impact, that is if the currency depreciates it will have an adverse impact.

Saurabh Dhar: Thanks a lot Sir, and wish you all the best.

Moderator: Thank you very much Sir. Okay, last in line, we have Mr. Mahantesh from Centrum Broking. Over to you Sir.

Mahantesh Centrum Broking: Good afternoon sir. I think a lot of discussion has happened, but one key question I thought begs an answer. When the rubber price in Kerala in the third quarter prevailed around Rs 75 to 80 a kg, why is it that you are procuring it at Rs 110? Even if I assume that there is a tax and duty element that I have to factor in.

Satish Mahajan: We said that Rs 110/kg is the average of the last quarter.

Mahantesh: But the rubber prices on an average have been around Rs 80.

Satish Mahajan: No, that is right now.

Mahantesh: No, in the December quarter. The October to December quarter. This is Rubber Board India numbers that I am quoting from.

Satish Mahajan: You may be right to the extent that December's rubber prices were lower, but Rs 110/kg is the average of the whole quarter.

Mahantesh: But there is substantial difference between Rs 80 and Rs 110 Sir.

Satish Mahajan: Yes rubber was at Rs 140 at the beginning of the quarter. We had an opening inventory of 15 days which is at around Rs140/kg. In October 2008, rubber was around Rs 120 plus, in November it was around Rs100/kg and in December 2008, it was Rs 90 /kg which makes an average of around Rs 110/kg.

Mahantesh: These are your consumptions Sir?

Salil Gupta: Yes.

Mahantesh: So then, Rs 89 can be expected to be much lower – say Rs 80 -- in this quarter or January onwards?

Salil Gupta: It is between Rs 70 and Rs 75/kg.

Satish Mahajan: In the next quarter, the overall RM cost is expected to be Rs 94 to 95/kg.

Mahantesh: But if December is Rs 89, and the rubber prices are still falling, then naturally from January to March, you should reporting rubber consumption at lower than Rs 89/kg , let us say Rs 85 or 80. Why should it be Rs 94?

Satish Mahajan: No, Rs 94 is the overall raw material cost. Rubber is 40% of the overall cost.

Mahantesh: Okay Sir. Thank you very much.

Moderator: Thank you very much Sir.

Satish Mahajan: Thank you gentlemen.

Salil Gupta: Thank you all very much.

Moderator: Thank you very much Sir. Ladies and Gentlemen, this concludes our conference call. Thank you for your participation. You may now disconnect your lines.
