

Apcotex Industries Limited
Q3 FY19 Earnings Conference Call
January 30, 2019

Moderator: Ladies and gentlemen, good day and welcome to the Q3 FY19 Earnings Conference Call of Apcotex Industries Limited. 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 also note that this conference is being recorded. I now hand the conference over to Mr. Anuj Sonpal – CEO, Valorem Advisors. Thank you and over to you, sir.

Anuj Sonpal: Thank you Bharat. Good afternoon, everybody and a warm welcome to you all. My name is Anuj Sonpal from Valorem Advisors. We represent Investor Relations of Apcotex Industries Limited. On behalf of the company I would like to thank you all for participating in the company’s earnings conference call for quarter 3 financial year 2019.

Before we begin as always, I would like to mention a short cautionary statement. Some of the statements made in today’s earnings conference call maybe forward-looking in nature. Such forward-looking statements are subject to risks and uncertainties which could cause actual results to differ from those anticipated. Such statements are based on management’s beliefs as well as assumptions made by and information currently available to management. Audiences are cautioned not to place undue reliance on these forward-looking statements in making any investment decisions. The purpose of today’s earnings conference call is purely to educate and bring awareness about the company’s fundamental business and financial quarter under review. I would now like to introduce you to the management of Apcotex Industries Limited participating in today’s call. We have with us Mr. Abhiraj Choksey - Managing Director. I request Mr. Choksey now to give his opening statements. Thank you and over to you, sir.

Abhiraj Choksey: Thanks Anuj. Good afternoon and welcome everyone to this earnings conference call for quarter 3 FY19. I hope you had an opportunity to look at the company’s performance for Q3 results as well as the earnings presentation which have been circulated and uploaded on the website and the stock exchanges. For Q3 FY19, the net turnover increased by 19% to Rs. 164 crores from 138 crores in the previous quarter Q3 of FY18. An operating EBITDA stood at Rs. 16.9 crores as compared to Rs. 17.3 crores in the previous quarter. The operating EBITDA margin was at 10.3% as against 12.54% in Q3 FY18. The PAT for Q3 FY19 was reported at Rs. 10 crores against Rs. 13 crores in Q3 FY18 with a PAT margin of around 6.1%. For the 9 months performance, the net turnover is also up by 19% to Rs. 473 crores from Rs. 399 crores for the

first 9 months of FY18. An operating EBITDA is at Rs. 53.6 crores as compared to Rs. 40.8 crores in 9 months FY18. The operating EBITDA margin is at 11.31% against 10.23% and the PAT is Rs. 31.3 crores as against Rs. 26.6 crores with a PAT margin of around 6.6%.

Some of the key operating highlights for the quarter are as follows. The company reported the highest ever quarterly sales of Rs. 164 crores in this quarter. EBITDA margins were under pressure this quarter due to a combination of reasons. One was a slowdown in the rubber and automotive segments especially in the last 2 months of the quarter. And we also found raw material prices coming down as a result of which we had some high inventories of imported raw materials that we were sort of settle with. A major export customers operation as I had reported before were close down due to a fire in April 2018, this continues to affect volumes and likely for the next few quarters as well till this customer comes back on stream. The CAPEX spend from Phase-I as on December 31st, 2018 was around 31 crores and the remainder will be spent over the next 6 to 9 months. The new ERP system, SAP S4 Hana went Live on December 01st, 2018 and I am happy to report that things are normalize now.

With this, I would like to open the call for question and answers. Thank you.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Sagar Gandhi from ICICI Securities. Please go ahead.

Sagar Gandhi: My first question is on the balance sheet and then second will be on the P&L. So sir, has your working capital position improved from what was there in H1 FY19? And what will be the debt levels currently, is my question number one. And question two is, how has been the exports for Q3 FY19 plus except for slowdown in rubber and automotive segments, how have the other segments in the domestic markets performed?

Abhiraj Choksey: As far as the working capital is concerned, there is no significant change from the first half. The debt, we have so far not taken on any long term debts, so as of now the company is debt free. And overall, besides the rubber and automotive segments all the other segments we had more than satisfactory growth in fact including exports were also we have had a good healthy quarter. As we do not give out volume numbers or specifics but I can tell you it has been a good quarter on all our latex segments especially carpet, construction, paper and across the board on exports.

Sagar Gandhi: Just in continuation with my previous question, sir I am referring to short term debt. So, is it, I mean has it crossed 35 crores number or is it below that number?

Abhiraj Choksey: It is still I do not know where, yes still below that number.

Moderator: Thank you. The next question is from the line of Mihir Parekh from Dhanki Securities. Please go ahead.

Kausal: Sir, this is Kausal here. Sir, your comments on the raw material price drop, what kind of inventory are we carrying and what impact are we likely to have because of that? So, that is first and second is if we have made any progress or any decision on that significant CAPEX which is coming up?

Abhiraj Choksey: As far as the raw material, most of these imported raw materials we have one, at least 1 to 2 months of inventory and we also sometimes have inventory in the pipeline coming in. Generally it takes about, this time the drop was pretty significant for a couple of our raw materials as much as 70%. This was something like sort of caught up unaware as well, I mean while we knew that things would soften. We did not expect them to soften literally overnight there was a crash for some of our raw materials which were linked to crude. Partly due to crude but partly also those specific raw materials and supply-demand things turned more in the sellers and the buyers favor. That happened quickly and so it takes about 2 to 3 months for this kind of inventories to finally be used up and I think that hopefully by January this month we should be done with those high cost inventory. As far as the significant CAPEX, as I said once after we took over we had made a CAPEX plan of about 60 crores-65 crores in our Valia facility which as I mentioned in my opening statement will be done in the next 6 months by June-July latest. In addition to that we are looking at, so those who are all linked to productivity improvements which would of course directly affect margins as well improve margins but also some debottlenecking in both our plants. So, all that will be completed in the next 5 to 6 months, in fact some of it is already been completed I would say. And in addition we are looking at about at 250 crores CAPEX project for 2 products. One is nitrile latex for gloves and the second is to expand our nitrile butadiene rubber business. Both those are at sort of I would say planning stages detailed planning stages. We would finally decide to go ahead by the end of this quarter. But clearly a lot of detail engineering is going on right now.

Kausal: So, just one additional question on that RM, the raw material part. So, should we expect that going forward in the fourth quarter they will not be any significant bleeding on account of that high cost inventory and therefore in fact on the contrary we could probably have some gains emerging out of the drop in prices?

Abhiraj Choksey: That is correct, at least from February onwards, yes.

Moderator: Thank you. The next question is from the line of Rohit Sinha from Emkay Global. Please go ahead.

Rohit Sinha: First of all, just want the clarification on the tax rate which I think has gone up in last 2 quarters. So, what tax rate would be continuing for the coming quarters?

Abhiraj Choksey: So, tax rate actually compared to Q3 of last year we had significant mark-to-market gains in our sort of treasury portfolio this was in Q3 of FY18. As a result of which, if you are comparing the tax rate of Q3 FY19 against FY18 is certainly higher or I would say it is normal now. Whereas,

earlier because of the high mark-to-market gains which were all long term capital gain and zero tax, effective tax rate for the company was lower.

Rohit Sinha: So, what tax rate normally we expect in FY20?

Abhiraj Choksey: Honestly, I do not have that number with me frankly.

Rohit Sinha: But would be below 30% or above 30%?

Abhiraj Choksey: There is no reason, I mean as far as the operational part of the business is concerned it will be at full, I mean at full tax rate.

Rohit Sinha: And next part on this margin side only when we can expect this margin to recover that was normal rate and do we expect to touch 14% kind of EBITDA margin coming up?

Abhiraj Choksey: Look as I had mentioned in the last couple of years, I think that is our endeavor to get to 14% once all these projects are implemented around 13% to 15% is what I mentioned. Of course, quarter-on-quarter you can have quarters like this and this in our kind of business where raw materials are quite volatile and link to crude. So, you can have certain quarters where you can have a lower than average, I would say lower than average EBITDA margins and some quarters you can have higher than average EBITDA margins. But if you see the 9 month period we have improved.

Rohit Sinha: And just a follow up question on the CAPEX thing which you have now. So, just one thing is that what about progress on the NBR side and when we can expect a power plant to commissioned?

Abhiraj Choksey: Power plant is expected to commission around June-July 2019, so about 6 months. And what was your other question?

Rohit Sinha: On the NBR capacity, when that will be also expect to commission? The 40,000 ...

Abhiraj Choksey: Detailed engineering plans right now and working on those. Once the board approves and we go ahead with that project in terms of the actual CAPEX it will be about 18 to 24 months. So, we expect that decision to be taken by the end of this quarter.

Rohit Sinha: That is currently on the planning stage only, right?

Abhiraj Choksey: Well, we have moved forward. We are doing that detailed costing, detailed planning.

Rohit Sinha: So, the CAPEX which is around 65 crores, the Valia plant. Out of that 31 is deployed till now, right?

Abhiraj Choksey: Yes, that is correct.

Rohit Sinha: And remaining would be by end of June or July?

Abhiraj Choksey: Correct.

Rohit Sinha: And these all CAPEX are into which product segment?

Abhiraj Choksey: As I said, they are multiple, well the major is the power plant out of this almost half is the power plant. So others are it is not a specific segment but it is overall for the plant.

Rohit Sinha: So, there we making all latex and gloves also include there?

Abhiraj Choksey: In Valia we are making NBR mainly. NBR is our main product, NBR and NBC.

Moderator: Thank you. The next question is from the line of Siddharth Purohit from SMC Global. Please go ahead.

Siddharth Purohit: Just one thing sir, that the CAPEX that you have mentioned that also it is not a debottlenecking and improving efficiency. But what is the capacity that has been added because of this the current CAPEX that is going on in the NBR side?

Abhiraj Choksey: About our earlier capacity was about 16,000 tonnes per annum. Now, we are able to we should be able to do 20,000 tonnes per annum going forward. It is about 20%-25%.

Siddharth Purohit: And what would be the ideal like utilization levels for the incremental the CAPEX that is done or the new capacity and the new one?

Abhiraj Choksey: We should be able to go back to 100% capacity utilization that is the plan.

Moderator: Thank you. The next question is from the line of Vijay Gala from Gala Consultancy. Please go ahead.

Vijay Gala: Sir, what is the export component from this turnover this year? Generally, 15%, 22 crores previous one, so are you going to touch the 100 crores mark today?

Abhiraj Choksey: This year, we have had a setback this year with one of our large customers as I mentioned. Therefore, I actually do not have the exact number with me right now. But I would say it is around 15% is what I broadly remember as a number approximately as ...

Vijay Gala: 15% is there 15 out of total turnover?

Abhiraj Choksey: Yes.

Vijay Gala: Your raw material prices come down, so what about the intake on your final products. So, how much it will be intake on the export side?

Abhiraj Choksey: In our business, we are able to pass along whenever cost go up, the raw material cost go up with some time lag we are able to pass it along. Similarly, when costs come down, we also because of competitive pressures have to pass those along. In this quarter as I mentioned we got stuck with some very high cost raw material which was unexpected, the drop in prices was unexpected for this raw material. So, we got stuck with some inventories. Is this answer your question?

Vijay Gala: Yes, thank you.

Moderator: Thank you. The next question is from the line of Farooq Tandol from Avista. Please go ahead.

Farooq Tandol: I just had a question on the given the fact that we expect from February the effect of the higher cost and inventory to wear off, will we be able to achieve margins similar to what we achieved in the fourth quarter of last year especially since we have a positive revenue momentum which is helping us a long? And the question had asked a couple of quarters ago, the sharp decrease in oil prices would that have, what sort of impact would that are going forward if prices had to sustain on these level? And lastly the other income loss on year-on-year, the other income sort of drop variance on a year-on-year basis was that due to the mark down of your investment portfolio?

Abhiraj Choksey: Let me try answer one by one. So, the first question is about Q4 margins. I honestly do not have the Q4 margins of last year in front of me but obviously there are as I said there has been quarters where we had better than expected margins, we had 16%-17% margin and at that point I have said that look these are margins that we could in one quarter achieve due to may be raw material gains just as you had some losses this quarter we had gains in the previous quarter. So I do not, while I do not know the numbers for Q4 last year exact margins in front of me, all I can say is that, yes we went through in the last 2-3 months we are certainly looking to move forward with that. However, having said that there is a little bit of pressure on pricing in our NBR business because of overall markets being a little slow. We see that improving slowly, Q4 certainly quite positive going forward at least in February and March. So, I hope that answer your question on Q4. Your third question on other income, first of all I do not think even mark-to-market losses but I think they were the gains in the last previous financial year 2017-2018 were much higher than what we have had in the first 9 months of this year. So, is that what you are asking?

Farooq Tandol: Yes.

Abhiraj Choksey: So, yes it is because of mark-to-market of our investments, yes. And your second question was on something to do with oil prices, I am sorry can you repeat that?

Farooq Tandol: The relation of oil prices to the sort of profitability and growth going forward?

Abhiraj Choksey: As I have always said, look we already prefer oil prices to be stable and low. And that is always good for us, it is good for our customers. But we have learned to live with the volatility and if volatility does happen with some time lag we are able to pass along the increase if that does happened.

Farooq Tandol: And just one more question on the 250 crores program that you had mentioned. The sort of structure of that program you would be in a position to talk more in detail about that at the end of the financial year, at the end of this quarter, is that right?

Abhiraj Choksey: That is right. I mean, principally we have taken a decision to go ahead but however we need full board approvals. So, that will come about by the end of this quarter, I think. Because we are working on some detailed plans and actually this 250 crores is an estimate. We will be having the exact detailed working and numbers by within the next 3-4 months and we may do it in phases as well. So, I think your question is perhaps how we are going to fund this is that sort of....

Farooq Tandol: Funding also and the timeline I think you had mentioned in the previous call would be to the order of approximately 2 years to implement?

Abhiraj Choksey: So, again it is, we are looking these 250 crores is going to be primarily made of 2 parts. One is for nitrile latex which perhaps will be about 50 crores-60 crores and the remaining 200 crores will be for the nitrile rubber. The nitrile latex project we may be able to do quicker may be in 18 months from the time we go ahead. And the nitrile rubber projects, yes 2 years because one of the other things about this the nitrile rubber project is we also need environmental clearances and certain permission. So, it would also be dependent on when we receive some of those permissions.

Moderator: Thank you. The next question is from the line of Kuldeep Razdan, who is an individual investor. Please go ahead.

Kuldeep Razdan: I have 2 questions. One is on the export, in the exports you said is about 75 crores of the total in the guideline this time. Now in this export customer who is not yet giving us any business and it is likely to come up and he is a large customer, I guess. How much difference does it make to our sales, when after 3 quarters or 2 quarters he comes up. Suddenly when there will be a jump in our earnings is that how big he is?

Abhiraj Choksey: Overall I would say, that one customer in FY17-18 would have given us about 18 crores to 20 crores of sales. And that has gone in 2018-2019 it was a specialty customer with reasonably good margins and we would selling a specialty product specifically develop for them. Unfortunately because of fire in the factory there is not much we can do. And they are one of

a kind customer who were gain their monopoly in their industry. Not monopoly but one of the major players in, yes so, it is about 18 crores to 20 crores a year of sale.

Kuldeep Razdan: So, that means, when that happens? When he comes back on line? There is likely to be a good jump in earning?

Abhiraj Choksey: In revenue and earnings, yes but it is unlikely that they come back for another year or so because entire plant is gutted.

Kuldeep Razdan: Sir, the second question I have is about your synthetic rubber, is generally use in automobile and automobile is in a slowdown more deadly as we understand now. Does it impact your sales? Are you seeing any slowdown in your sales in India?

Abhiraj Choksey: Yes, absolutely. Absolutely, I think in the last 2-3 months and I mentioned that in my opening remarks that not only automobiles but in generally in the rubber industry and may be a lot of it is linked to automobiles indirectly or directly. We have certainly see the slowdown from November fairly, I mean we are not able to explain it. Maybe some automotive customers would be better place to answer that question of why. But having said that, in the second half of January again we have seen a good pickup, so we are hopeful that February-March that will continue into February and March. But yes, for about 2 to 3 months we did see a fairly significant slowdown in the automobile industry.

Kuldeep Razdan: That is so, your sense is that another 2-3 months and when we will be over with this slowdown?

Abhiraj Choksey: No, I am actually hoping from what the signs are seeing in last few weeks I am hoping that, I am already behind us.

Moderator: Thank you. The next question is from line of Rohit Sinha from Emkay Global. Please go ahead.

Rohit Sinha: Just wanted to check the growth which we are seeing in this raw material prices mainly your styrene, butadiene and your acrylonitrile. So, as per our calculation, I think butadiene prices were up by 30%-35% on Y-o-Y-basis, whereas Styrene and acrylonitrile prices were down by somewhere 15% to 10%. So, is that a right calculation or is there any deviation on that.

Abhiraj Choksey: Frankly, I will be frank. I do not have those numbers in front of me. It is a public number, I am sure you get them from anywhere on the year-on-year basis. I can come back to you if needed.

Rohit Sinha: So, majorly I just wanted to get sense is that because of major accretion in the styrene and acrylonitrile does that effect more or butadiene prices remaining up would affect more to us?

Abhiraj Choksey: So, I think in the last quarter if you see it is a nail on the head, styrene and acrylonitrile was a huge crash. In fact, maybe more than 40% to 50% for styrene and up 60%-70% for ACL and it happened in a very short period of time. So, one is looking year-on-year numbers but also do

if you look at the details of when these crashes happened then you will be able to analyze few other things as well for those numbers. Having said that all 3 raw materials are important for us, of course styrene and butadiene in terms of overall consumption is more than ACL. They would affect us more, yes.

Moderator: Thank you. The next question is from the line of Abhinav Sahu from NC Research. Please go ahead.

Abhinav Sahu: I am trying to understand if, I mean the slowdown in the end market as far as the auto is concerned, could be a mix of both the higher inventory in the system as well as and also the slowdown in the demand side. So, my question with respect to inventory, if the inventory correction is already done and now more a factor of how the auto sector now improves from here?

Abhiraj Choksey: Yes it be, this is what I hear as well. It was a combination of the both, of both the.

Abhinav Sahu: And sir how much our sales share would be with auto sector?

Abhiraj Choksey: I would say approximately overall from a company point of view about 20% to 25% of our sales is linked to the auto sector. And that is not tires I am only talking about auto tires is another may be 10% or so. So, tires and auto which I guess logically it is probably two then it is 35%-38%, yes.

Abhinav Sahu: So, capacity expansion which I understood from last time was that you are looking for and we have capacity of around 15,000 and latex of 40,000. Is it right or is there any change in that?

Abhiraj Choksey: Yes, so there is slight change in these. These numbers that I am talking about right now is about 50,000 crores will give us capacity of about 26,000 tonnes of latex and 200 crores will give us about 15,000 tonnes of NBR, correct. 420 crores to 440 crores turnover topline.

Abhinav Sahu: And sir, any insight you want to share regarding your new products like the carboxylated nitrile, any traction on that side how this demand is and so on?

Abhiraj Choksey: We are very small player. We have just started and we are producing from our Talaja plant with whatever capacity we have in Talaja plant left over. That is temporary till we have the new reactor in Valia, this is a sort of temporary plan. We have already started producing and selling. However, of course our ambition and our aspiration is to do much higher volume. The market is large, even if we sell our entire 26,000 we may not be even be, we will be a very small market share or market player. So, of course long term aspiration is that 26,000 tonnes goes well then of course to keep growing on that front. And we are one of the few in this part of the world.

Abhinav Sahu: And this is mostly exported? How much is exported here?

Abhiraj Choksey: Right now, we are exporting and we are selling locally. But yes, eventually it is mostly an export market.

Moderator: Thank you. The next question is from the line of PJ Shah, who is an individual investor. Please go ahead.

PJ Shah: I am PJ Shah here. This is with respect to 250 crores expansion plan in pipeline, it will be funded how? And second, export is with good margins or exports are with low margins that I wanted to understand?

Abhiraj Choksey: So, I will answer your question CAPEX funding, as I said of course there will some amount will be through internal accruals and some amount of debt. I think we will decide, we will take a decision on all that over the next 3 to 6 months on the funding. As far as the export is concerned, we have common customers and products that are high margin and some there are low margin. I do not want to, I do not think it is correct to say that exports is in general higher margin business.

Participant: Then so, export has no meaning? It just increased the turnover and no profit, is it?

Abhiraj Choksey: I did not say no, profit. If you are comparing to domestic, I do not think it is fair to say it is higher margin, a similar margin to domestic.

Participant: And that 250 crores will be internal accruals plus borrowed or an increase capital?

Abhiraj Choksey: The plan, I mean as I said the details have not been worked out. So, over the next 6 months it will be clear on the funding as well. But most likely we expect that we think goes well, it will be through internal accruals and some through debt.

Moderator: Thank you. The next question is from the line of Arpit Bhatt from HDFC Securities. Please go ahead.

Arpit Bhatt: Sir, the question is again related to the CAPEX that you have announced. So, I just wanted to understand that the capacities that you just mentioned of 15,000 tonnes for NBR and 26,000 of latex. Those would be the additional capacities, right incremental ones?

Abhiraj Choksey: That is correct.

Arpit Bhatt: And the amount of 250 Cr, so is it a Greenfield project or is it a Brownfield project? So, will it include the cost of land that will be required or is just the plant and machinery?

Abhiraj Choksey: This is Brownfield.

Arpit Bhatt: And you just mentioned somewhere that, so we expect some 400 crores to 420 crores of turnover, just now, did you just say about that?

Abhiraj Choksey: Yes. About 420 crores to 440 crores, yes exact number.

Arpit Bhatt: So, on a CAPEX of around 250 crores, so that will be at what? 50%-60% utilization or 100% we are talking about?

Abhiraj Choksey: At 100% utilization.

Arpit Bhatt: And the margins will be similar to what we are earning right now? So, around 14% to 15% the margins that we are expecting.

Abhiraj Choksey: We would hope we can do better because overall as the plant size grows bigger the overall per Kg costs will keep coming down. But yes, I mean at the minimum we would want those kinds of margins, yes.

Arpit Bhatt: So, the major improvement will be on the operational efficiency is that we are trying to get in with the current CAPEX and with the operational leverage that we will have with more of the volume that we will be generating, correct?

Abhiraj Choksey: That is right.

Moderator: Thank you. The next question is from the line of Jigar Shroff from Financial Research Technologies Private Limited. Please go ahead.

Jigar Shroff: I just wanted to understand a bit about the situation in China in terms of slowdown and how does it impact our products and how do you see the situation evolving in the medium term? Thank you.

Abhiraj Choksey: We do not directly compete with China in anyway, compete nor do we buy anything nor do we sell much to China. We do export some amount to China but we do not buy or sell much. And as I said we do not have competition from China directly. But yes, I mean what is happened with the whole US-China trade was there is certainly going to be a global impact. For example, what happened is recently China has sort of they have imposed an anti-dumping duty on Korean and Japanese NBR into China. That was a big market for Korean and Japanese, Chinese market. Now they are, they were always looks for other avenues to sell. What that kind of impact that has to on India and us, I do not know because we do compete with Koreans and Japanese in the NBR market.

Jigar Shroff: That fear of dumping, do we have some FTA with Korea and Japan. Or I mean, would that be on the table in terms of their products being dumped into India?

Abhiraj Choksey: That is possible. Absolutely possible, I mean that is one of the risks, that is there in this business and of course, since you specifically asked about China and the slowdown, I do not think this slowdown really affects us. But this whole US-China trade wars and the political impact in, the impact of that on our business certainly there is there could be an effect. I am not sure.

Moderator: Thank you. As there are no further questions, I would like to hand the conference over to the management for closing comments.

Abhiraj Choksey: Thank you everyone for your time. We look forward to see you again next quarter. If there are any clarifications that you need you can always contact our company offline. Thank you.

Moderator: Thank you very much, sir. Ladies and gentlemen on behalf of Apcotex Industries Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.