APL Apollo Tubes Limited

Q1 FY2018 Results Conference Call
September 11, 2017

Moderator: Ladies and gentlemen, good day and welcome to the APL Apollo Tubes Limited's Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Anoop Poojari from CDR India. Thank you and over to you, Sir.

Anoop Poojari: Thank you. Good evening, everyone and thank you for joining us on APL Apollo Tubes Limited's Q1 FY18 Results Conference Call. We have with us Mr. Ashok Gupta – Managing Director of the company; Mr. Sharad Mahendra – Whole-time Director and Mr. Deepak Goyal – CFO of the company.

We will begin the call with Brief Opening Remarks from the Management, following which we will have the forum open for an "Interactive Question-and-Answer Session."Before we begin I would like to point out that some statements made in this call maybe forward-looking and a disclaimer to this effect has been included in the 'Earnings Presentation' shared with you earlier.I would now like to invite Mr. Ashok Gupta to make his opening remarks.

Ashok Gupta: Good Evening friends. It is my pleasure to invite you all and welcome you to this APL Apollo Conference Call to discuss the Operational and Financial Results for the Quarter ending June 30, 2017.

After I give an Overview, my colleague, Mr. Sharad Mahendra will take you through the Key Developments and Strategic Initiatives and after which the CFO, Mr. Goyal will share some Financial Highlights.

Before I start with the figures, I would like to share with you with pleasure Four Key Developments which have happened in the last few days or months. First of all, I am very happy to inform you that APL Apollo has become the first company in the country to manufacture 300x300 Square Sections. These Sections hitherto were being imported from outside particularly from Corals. Now, it will be made in India. This will be a big jump for the company; it will also be a jump for the infrastructure of the country. Because many people were trying to use some alternative, not sufficient means to do same job.

Second big thing, which has happened is that we have been talking for quite some time about our DFT technology coming and how we will be able to produce unconventional sizes from this technology. Again, I am happy to share with you that during last few days, we have made 12 such unconventional sizes, that means 12 sizes which were never there earlier in the whole economy, have been started by APL Apollo now. This is a big jump and a big benefit of this kind of a proof of the concept that this technology can work and it can create unique innovative products.

Third thing which I wanted to share with you was that CRISIL has given us ‘AA’ rating for our long-term debt. This is again a big feather in our cap. There are very few steel companies, particularly in the mid cap sector which have been endowed with ‘AA’ rating.

Fourthly, I want to share with you, we have been talking about how branding can benefit us. You will be happy to know that we had launched what we call “Coastguard”, special type of Pipes, particularly in the Kerala region. While overall growth in the country for pipes might have been in the range of 8-10%, Coastguard has recorded a growth of over 45% y-o-y for Q1. This is remarkable anda proof that the branding exercise which we were thinking of starting in a big way has given us a result on an experimental basis.

So, I think these were the few developments. There are a few more developments which my colleague, Sharad will talk to you about.

About the results, you are already aware that we have reported 11% volume growth. Now, we had a setback in the month of June just before GST was implemented, this was faced by most of the industries as well and was on expected lines. But after GST, things are much better. On the EBITDA level, we have been almost in the same range of about (+/-) 3,300 and which we have been maintaining for some time. In the days to come, with DFT and other technologies this figure also should improve and we should be seeing better margins.

As we have been mentioning earlier as well, there has been a shift from the unorganized sector to organized sector which was giving a thrust to people like us in the organized sector where the demand seems to be picking up and consolidation is taking place in the industry.

Secondly, faced with these difficult challenging times, our response time to the market has also improved. Today, the company has become more agile, we are looking at the industry, we are looking at the market, we are looking at demand, and we are looking at customers and responding very fast. That is the reason we have been able to grow faster than our peer group.

Thirdly, we have been talking to you about the direct sales to OEM customers. Here again we have got good results. People are responding to our approaches, people are coming back to us, they are placing their faith on us and we are getting very good response from them.

So these are the reasons why we have been able to sustain and I should say takeover demand from our competitors which initiative which I am sure will continue in a much more rigorous manner in the months to come.

Macroeconomic environment continues to be good for the country I hope even with GDP growth of 6.5%, the demand for Pipe industry should increase even more. On top of it, the substitutes of wood and cement are likely to be affected in days to come and again shifting the demand. More and more people are shifting from wood and cement to steel, particularly Sections and Glass which is giving us a much better results.

So overall I feel that in days to come, demand will grow faster for us and with GST on our side, perhaps better days are ahead for us.

With this, I will hand over to my colleague, Mr. Sharad who will give you much more details.

Sharad Mahendra: Good evening everyone. In continuation to what Ashok ji has just informed, there are a few more to add in terms of our approach towards the market is that our focus in the Q1 this year has been on the value added products. As had been told that we have achieved the growth, which is much higher than what our overall volume growth is, and in addition to that, there has been good order book from the OEM and project customers and this has been possible basically apart from the construction and infra, which consume maybe a large portion of our business. We have also entered into Yellow Goods, Agricultural Equipments and also into Automobile segment. This has been the new entry segments for us which has given us new opportunities and with the commissioning of the Direct Forming Technology, the new line, we see this portion of our business in the Yellow Goods, in auto equipments, auto parts and agricultural equipments to witness an incremental growth because with the commissioning of the 300x300 line, the opportunities open up in a much bigger way. In addition to that, our focus has been in a big way on branding, wherein in Q1 FY18, we launched the brand Apollo Coastguard which is galvanized and Pre-Galvanized Pipes which are more suited for the coastal areas and Kerala, being the biggest market, it is almost now more than five months we have been seeing a good acceptance of this brand in terms of the order book and in terms of the price line and the brand premium that we are getting. So we will continue to focus on that. In addition to that, we have plans of launching more brands with an approach of moving from a commodity to branded products because this industry being majorly treated as commodity, so that is the range. Today, we are happy to inform that almost 70% of our portfolio is now catering to a niche market and with the startup of Direct Forming Technology; this is likely to increase even further.

Our approach has been now in terms of like approaching the B2B customers, OEMs and project customers, which is basically more of B2B sales, wherein we are approaching the customers with the technology and the advantages. For B2C segment, which caters to a very large portion of our business, branding is the key wherein we are moving ahead and we will be doing much more activities in terms of brand launch and brand strengthening going forward in the second half of the year which we have already started.

Apart from this, we are going into the market with the approach of what we have internally nomenclature as CAP wherein C stands for the new customer addition which is basically resulting into de-risking of our business having a larger base of customers and A stands for basically the new Areas where we have not been present and especially with the commissioning of our Greenfield plant in East in Raipur, we are entering into the new markets in East where we have not been doing any business till now and in terms of P, P is the new Products which we are introducing in the market especially with the Direct Forming Technology, these three approachesare likely to give us incremental business. We have been witnessing a good acceptance of our approach in the market in July and August months, which is visible now.

Apart from that, a latest development in terms of keeping our focus and moving more towards the value addition, we are happy to announce that we are going ahead with the joint venture with the Japanese company, which is 1:1 holding company with the name of o2Oh,which is Singapore-based, and their own company with 100% holding, Daiwa Steel Tube, which is a Japanese company, making a very-very specialized product which has not been manufactured anywhere in India or in nearby countries. So we are beginning in an absolute new technology and we hope to sign the joint venture very soon and maybe first half of next financial year, the capacity is likely to get commissioned. So these are few initiatives which we have taken.

To summarize, basically, one is the Branding, one is the OEM and International business and the third is in terms of the joint venture and increasing our value added portfolio.

Last to comment on our exclusive MoU which we have signed up with NEXTracker. We are happy to announce that the guidance which we gave was that in second half of FY18 we are ready and we will be definitely starting this business from October 2017- this is a value added higher margin product which is expected to give us even positive guidance for the next six months also in the current year.

With all these, the outlook what we see is that we are going to lead the ship from a commodity to a value-added branded product at APL Apollo.

Now, I will request my colleague, Mr. Deepak Goyal, CFO, to just address you. Thank you.

Deepak Goyal: Thank you, Sir. Good Evening, everyone. I will briefly cover theFinancial Performance for the Quarter under review.

Before we begin, I would like to highlight that as per the statutory guidelines, the company has implemented the new accounting standards and we have reported our financials by IND AS, we have included the detail in the notes to accounts of our earning table. Overall, there has been no impact on our financials.

Coming to the Financial Performance during the quarter, our total net income stood at Rs.1,155 crore, recording an improvement of 18% year-on-year. Total sales volume stood at 2.65 lakh tons, higher by 11%. The latter half of the month of June saw a slight slowdown in the business activity on account of GST implementation. This impacted volume to a limited extent. Realizations across product categories also marked growth led by the higher steel price; however, as you all are aware, we tend to directly pass on any change in the steel price to the customer. EBITDA during the quarter stood at Rs.88.2 crore, lower by 9%; EBITDA margin stood at 7.6% as compared against 10% in Q1 FY17. The corresponding quarter in the previous year saw benefit of the minimum import price on HR Coil including inventory gain which led to a higher than normal margin in Q1 FY17. Depreciation during the quarter was higher by 20% at Rs.12.2 crore. The increase was due to the commissioning of new capacities which were capitalized during the quarter. During the quarter, PAT stood at Rs.38.8 crore against Rs.43.8 crore. EPS stood at Rs.16.08.

FY18 starts on an encouraging note for us as we deliver healthy progress across our operational and strategic lever. We are seeing a healthy uptick in the business activity from the month of July and look forward to recording healthy volume in FY18.

This brings us to end of our discussions. I would now request the moderator to open the forum for Questions. Thank you.

Moderator: We take the first question from the line of Saurabh Patwa from HDFC Mutual Fund. Please go ahead.

Saurabh Patwa: Just wanted to understand that in this quarter, we had commissioned DFT technology-based plant and also the Raipur plant. Does this impact our margins?

Ashok Gupta: There has been commissioning of both DFT technology and Raipur plant during the quarter. But we are just commissioning these, the production will pick up in the days to come and only by year-end, the entire commissioning will be over and production will improve in stages. So this year we are expecting that our volume which normally should be growing around 20-25% that to be maintained and this will carve significantly from the new technologies, including DFT and also from Raipur.

Saurabh Patwa: So going forward, we expect margins to improve from these levels?

Ashok Gupta: Typically, they have been at around 3,300-3,400 in this current year, next year it should be further improving. Now the environment in which we operate is quite competitive. Because of the DFT technology, there should be some improvement, but improvement will be very gradual, you may see slight improvement in next quarter. But we have to increase our volume by 20-25% against the industry growth of around 8-9%, so it is possible that our margin growth may not be very-very significant.

Saurabh Patwa: In this quarter,it has been slightly lower than 3,000.

Ashok Gupta: I will suggest that a month-to-month, quarter-to-quarter volume comparison is not right, because on average there will be price increase/decrease, raw material increase/decrease, sentimental change. But if you see the year as a whole, it will be around 3,300 plus/minus something.

Moderator: The next question is from the line of BhavinChheda from Enam Holdings. Please go ahead.

BhavinChheda: This quarter we reported 11% y-o-y volume growth. Are you still guiding for 20-25% growth in FY18 since we are into September already?How has the post-GST July-August volumes been? Are you still confident of 20% y-o-y volume growth?

Ashok Gupta: We have been able to make up some shortfall in the Q2 FY18, so Q2 FY18 will be definitely more than 20-22%, so there will be some makeup of whatever we lost in Q1FY18, Q3-Q4 FY18 we will further try to make up. So the year as a whole should not be less than 20% any case but should be perhaps around +25%.

BhavinChheda: So roughly we should be crossing 1.2 million volumes in FY18?

Ashok Gupta: Yes.

BhavinChheda: As a reply to earlier question, you said you are confident of around Rs.3,300-3,500/ton. Because this quarter, margin per ton was Rs.2,830/ton, so which means for the remaining months you are looking at close to Rs.3,500/ton, right Sir?

Ashok Gupta: There are always some changes in the raw material prices which affect the margin for the stock gain/loss. But they normally even out during the year. There was a price reduction in the month of April, May, June, earlier there was a price increase in July to September, these are evening out. So the year as a whole, we will be hoping for Rs.3,300-3,500/ton.

BhavinChheda: This new DFT line which you have started, what capacity that has added and how much time it will take to stabilize and ramp that up?

Ashok Gupta: We have been adding in stages one-by-one. So capacity will take a lot of time to really mature. By this year end, we expect to commission all the lines. So our capacity by March will be around 2 million tons against 1.3 million tons which was there last year. So if you see all the lines will be commissioned, basically it will add 0.7 million tons additional capacity.

BhavinChheda: What will be the capex this year and current net debt level?

Deepak Goyal: This year capex will be around Rs.100 crore to complete our last year's plan of Rs.300 crore to expand our capacity from 1.3 million tons to 2 million tons, it is almost at the same level at March, but in the Q2 ending, it will be slightly higher because of pricing trend in the raw material prices.

BhavinChheda: Rs.100 crore capex includes maintenance capex?

Ashok Gupta: Maintenance is very small; not more than Rs.10 crore typically, but it includes everything.

Moderator: The next question is from the line of Rajnath Yadav from Choice Equity Broking. Please go ahead.

Rajnath Yadav: You have commissioned two lines – one in Hosur and one in Raipur. Just wanted to know, what will be the expected DFT sales volume in FY18 and FY19?

Sharad Mahendra: DFT volumes will be gradual and all the lines will get commissioned during the year by the end of the current fiscal. So this year what we expect is that maybe all the lines will not be commissioned at the same time and capacity will get added on a particular day and the utilization will slowly improve. So we expect close to 12-15% of our total sales in the current fiscal from the DFT technology.

Rajnath Yadav: What about this current DFT technology, that is 0.25 million tons which we have commissioned, this will be available for next six months, so from that how much we will be able to generate because rest of the projects will be commissioned in FY18?

Ashok Gupta: We have the prerogative of shifting between the conventional method and the DFT. DFT we will try to use only for special purposes and we will be trying to ramp up and create new products. So from this 0.25 million tons, we will be getting some capacity this month, next month, more capacity will be commissioned and again some capacity production addition. So the year as a whole, we are expecting to make around 1.2 million tons. So if you just take 10% of it, we should be selling around a lakh or lakh plus from DFT, balance will come from normal mills which are conventional mills, by next year this percentage should increase significantly.

Rajnath Yadav: As far as the sale of GI Pipe is concerned, it is declining for the second consecutive quarter. So any specific reason for this?

Ashok Gupta: If you see our GI sales, they are hovering around 30,000. The difference of 2,000-3,000 cannot be taken as a decline or increase because this depends on the thickness and diameter and all of those factors. If you see hovering around 28,000-30,000, they will remain that way because our capacity is that much, now we are trying to add some more capacities. Once those capacities are added it may take six months to one year, then this should see a significant jump. But there is no decline per se. Last year, we had made in Q4 around 29,000, this quarter it is 29,000, so they have been hovering around 29,000-30,000 for almost five-six quarters.

Rajnath Yadav: What was the reason for drastic increase in raw material cost during the quarter?

Ashok Gupta: Raw material cost is steel prices, which depend on international scenario which means Chinese have been having a lot of variations based on their pollution and based on their diseases and based on their own financial parameters. So I must say that it is because of the internal Chinese problems or the policies or the facilities which the government is giving. Chinese prices have been moving and with Chinese prices, global prices have been changing and with global prices, Indian prices have been changing.

Rajnath Yadav: So was that the major reason behind contraction in the EBITDA margin?

Ashok Gupta: EBITDA margin normally price is a pass-through, so normally we talk of rupees per ton except for the fact that we may have some stock gain or stock loss. With Rs.100, Rs.200, you cannot really evaluate because this is not something which is precise. But in the range if we talk of, they have been ranging between 3,300 plus/minus few hundred.

Rajnath Yadav: If I go by EBITDA/ton, it is at eight quarters lowest level, means at around 2,900.

Ashok Gupta: So if you take out the stock losses, then again it will come to around 3,200-3,300 only. In this quarter the price of raw material and price of finished goods were lower than in the previous quarter which is Q4. That is why I mentioned, that let us not look at any quarter-wise EBITDA per ton. What typically happens is in one quarter there could be stock gain, in another quarter there could be stock loss. So that gets affected into EBITDA margin. But if you see the year as a whole, then all those up and down gets evened out, so the figures are more normalized.

Rajnath Yadav: What is the total sales volume from OEMs and export?

Sharad Mahendra: In this year, the total volume from exports and OEMs is close to about 50,000 tons is what we have done.In terms of percentage, it is close to about 7%.

Rajnath Yadav: So we have increased from 6% to 7% on sequential basis?

Sharad Mahendra: Also, I would like to tell you, major growth which has come is from the OEM and project sales in the domestic market. As we have seen that April to June, the prices in India were there for the raw material internationally, there was price which was not increasing, there is always a time lag, so internationally the material available was at a much lower price as compared to the prices of raw material if we relate in India. So for us to export, this may have impacted the margins, so we have focused more in the domestic markets, but the international market also, prices for our products were in line with the market in the second quarter and July, August, September quarter we are seeing a significant increase even in exports market apart from the OEMs market. So the percentage of OEMs and export is increasing and likely to improve further in Q2.

Rajnath Yadav: The Company is planning to raise around Rs.200 crore through non-convertible debentures. So what is the reason when we are generating sufficient cash flow and this will be for which project?

Ashok Gupta: We just mentioned that we will be needing around Rs.100 crore for our capex itself, that will be significantly coming from the own resources. Secondly, when we are increasing the overall volumes, we will also need more and more expenses.

Deepak Goyal: We have taken a provision for replacing the high cost debt with low cost debt. Since our rating is now improved to 'AA' we are planning to take new debentures till the old high cost is valued at.

Rajnath Yadav: What will be the expected rate going forward with this new facility?

Deepak Goyal: Around 7.5%.

Moderator: The next question is from the line of Pawan Kumar from Unifi Capital. Please go ahead.

Pawan Kumar: We are going to do a JV, where we are proposing to put up 50,000 ton capacity by H1 FY19. So what is the kind of investment that we are planning?

Sharad Mahendra: The total investment in the project for this 50,000 ton capacity to be commissioned in H1 of next year including the working capital is close to about Rs.100 crore total, out of this 60% is the debt and 40% is the equity which is in the ratio of percentage of 66% with APL Apollo and 34% with our joint venture partner. That is how we are going ahead with this project. Initial requirement including working capital is close to Rs.100 crore.

Pawan Kumar: What is special in this technology?How does a product get differentiated when we have this technology?

Sharad Mahendra: Normally, a coated pipe is made from two technologies, presently in major part of the world and also in India, it is exclusively either made through the Pre-Galvanized coil or it is that the black pipe is made and then object is galvanized. As compared to that, this is a product which is basically the pipe is made and the coating is done on-line only after the pipe is welded, from outside and inside there is a coating of high percentage of zinc coated paint. What happens to this is, this is a product which is most suitable in construction, in infra, which is the scaffold market wherein presently the black pipe is being used, so this is where we shall replace and the advantage for the end consumer is that the product lives increases. The present product can be used for two projects or three projects,but this product can be used for five projects or six projects and the number of years may also double. This is a product ideally which is very much suitable for the green house segment also. So these are the various segments wherein it is being used in other developed markets internationally. So we see that there is a lot of advantages to the end user in terms of cost advantage and to us also in terms of much better margins.

Ashok Gupta: So I will just put the five advantages that he has mentioned – Inline processing as against outside the line otherwise, lower galvanizing cost because you are using less zinc, lower weight because you are using less zinc and less weight as a whole, higher tensile. On top of all that, you get a better finish because uniformity comes up.

Pawan Kumar: From what I understood of your answer to the previous participant, that there has been Rs.4-5 crore inventory loss in this particular quarter, is my understanding right?

Ashok Gupta: That is a good estimate. Inventory loss is not something which you can conclude to a large degree, but the estimate seems to be quite close.

Pawan Kumar: Going forward, are we expecting Rs.3,300/ton instead of Rs.3,000/ton that we have done this particular quarter?

Ashok Gupta: It should improve even from that level; we are working towards Rs.3,300/ton plus level.

Pawan Kumar: At least for FY18 on a full year, can we expect that kind of margin?

Ashok Gupta: Yes, we are trying to target that.

Moderator: The next question is from the line of Saumil Mehta from BNP Paribas Mutual Fund. Please go ahead.

Saumil Mehta: What I am trying to understand is over the last couple of quarters we have seen some pricing pressure. This is despite 70% of our products having into niche category where we are facing limited competition. Just trying to relate when we actually see a structural uptick in prices or the completion is getting fierce. I am just wondering what is actually restricting the end product pricing for us?

Ashok Gupta: Two things – A) We are all aware that the steel pipe increase or decrease in the raw material prices are a pass-through, so our prices are just decreasing and increasing in relation to the raw material. Secondly, so far as EBITDA margins are concerned, we can have higher EBITDA margin but in that case growth may be kind of compromised. Since we are looking at 20-25% growth, our EBITDA margins will be in this range or there will be marginal improvements in the months to come. There are a couple of things we are doing to make sure that we can face competition. So there are a couple of things which we have talked about – one is the DFT technology, we are talking about making special sizes, we are talking about 300x300, incidentally, no other players in the country makes 300x300, we are talking about inline galvanizing, again nobody else makes inline galvanizing and more than that we are going to do a big communication exercise where we are going to differentiate our products. These are a couple of things which in the long run it will take time, it would not happen overnight or a day. But in the long run, people will recognize us as a very dominant strong, good, trustworthy player and obviously that brings loyalty. So we hope to face competition always, but we hope to face competition from a stronger wicket by taking these steps. But let me tell you, I do not think overnight the EBITDA margins will increase significantly, slowly but gradually we will definitely improve.

Saumil Mehta: In terms of our contracts, do we have like a quarterly contracts or spot contracts for our raw material and how would have that changed over a period of two years or so?

Ashok Gupta: Typically, in India, steel prices are fixed on monthly basis. So the steel producers including SAIL and JSW, they announce their prices in the first week of the month and sometimes there may be minor realizations during the month but normally that happens in the first week of the month and the subsequent producer that is the article manufacturer like pipes and CR, they follow the same line passing through the increase. So that way, there is nothing like a quarterly contract or a yearly contract. We have yearly MoU for quantity that we will be getting this much quantity from the producer. But pricing depends on month-to-month basis.

Saumil Mehta: How frequently do we change our prices for iron products?

Ashok Gupta: I will say that we do it almost same time as the main producer for steel will do. At the most we may do it in one part or two parts, that means suppose they increase by Rs.1,000, I may increase Rs.700 today and after weeks Rs.300. It has to be a pass-through. If the increase is moderate, we make it perhaps in a one-go. If the increase is steep, then we may go into two-go. Otherwise, we do not increase or decrease our prices very-very frequently; we do it only as frequently as the steel producers do it.

Saumil Mehta: Coming back to our niche technology and niche products, is it fair to assume that over a medium term the increase in end product prices for us will be far higher than the raw material prices because the raw material prices would be more of commodity grade whereas we do more of specialty and niche products, will the margin expansion for us be on a structural uptrend?

Ashok Gupta: If I talk of a particular product, for example, 300x300, definitely my margins will be much higher, my product size will be much higher. But when we average it out of the million tonnes, then you will be seeing the shift is very-very small, for example, I may be getting a very high EBITDA margin in terms of rupees per ton from a particular section or from a particular product, but when I am averaging it, it may again translate to around Rs.100, Rs.200 improvement. On the balance 90% there has not been any significant increase in the EBITDA. But these small changes of Rs.100-200 over a period of next 20-30-months will improve in good number in totality.

Saumil Mehta: So let me put the other way; I understand for Hollow and for Black Round we would not be able to do that, but is it fair to assume that for the Galvanized part of the business, the increase in end product prices will be sharper than the raw material prices given that we would be facing very limited competition over there?

Ashok Gupta: But for Galvanized also we face competition and we face competition for round as well as for sections. Only thing is there are special sections, like DFT, which are not made by others, like 300x300 which is not made by others, there of course our pricing power is better, but galvanized material is made by many other producers. So we have some advantage due to branding, but we do not have a very large advantage.

Moderator: The next question is from the line of Ravi Sharma from Aster Capital. Please go ahead.

Ravi Sharma: I would like to ask you regarding the past financials and the consolidated numbers of APL Apollo. If we see the standalone balance sheet, the EBITDA margin of APL Apollo will be approximately around 4.4-4.5% in FY17, but on a consolidated basis, it increases to 7-7.5% EBITDA margins. So in terms of product profile and in terms of region, because in the north side and the western side, you have a manufacturing facility and southern is more specific to galvanized product. So in terms of region wise, does the same product have different EBITDA margins and EBITDA margins for different products is also different for different regions?

Ashok Gupta: You have a point when you say EBITDA margins could vary from region to region; it happens for all the products depending on local competition and depending on who is the stronger player. So in some products, we are stronger in a particular region, in other products, somebody else is stronger. We normally take the company as a whole because mostly for the subsidiaries. It is only because we had acquired those companies, so they continue to be subsidiaries, in days to come they will get it. So that is why we mostly talk of consolidated numbers and not individual external numbers. So these numbers obviously depend on the product, the regions where we have sold.

Deepak Goyal: We have galvanizing production team in our subsidiary companies, Lakshmi and Apollo Metalex. So that is why at consolidated levels will have a better margins and APL Apollo, we have three units mainly in the production purpose black and Hollow Sections Pipes. That is why it is slightly different. We have a total product basket region wise. In South, we have one in Hosur, we are making the Hollow Sections and Round Pipes, in Lakshmi, we are making Pre-Galvanized Pipes, in North also in Apollo Metalex we are making Pre-Galvanized Pipe and in APL Apollo we are making Hollow Sections and GI Pipes. That is why in consolidated level, our EBITDA margin is 7.5% and in standalone EBITDA is lower than that.

Ravi Sharma: As far as your competitors we can see, they do not record EBITDA numbers as you are recording in the past four-five years, so you are on the higher side. So what is the reason for recording such a higher EBITDA margin as compared to competitors?

Ashok Gupta: A couple of reasons are there. I would not be able to really comment too much on the competitor on what they are doing. But so far as we are concerned, we are focusing on four-five things which should give us the advantage. One thing we are of course focusing on is the customer service, customer experience. So my colleague, Sharad is working significantly in ensuring that customers do not have any complaint. They are really given comfort, convenience. So we have opened our depots at each and every nook and corner so that we are close to the customer. Second thing we have done is if you observe, we are continuously increasing our operational efficiencies, we are working a lot on reduction in cost, reduction in inefficiencies. Every organization may have some inefficiency. In our company, there is a lot of focus given on removing those inefficiencies which improve our EBITDA margin. Third, at any organization, if the volumes improve, then we expect that there will be some improvement in the profitability. Apart from that, we have been continuously working on new products, innovation and our product basket. Each new product which we find is not there with a competitor, we should expect some better profitability. These are some few things which we are doing because of which our profitability would be better.

Sharad Mahendra: Apart from this, if you see since last many quarters, our EBITDA margins have been better as compared to others. Also, one of the factors is that if you see our pan India presence in past, we have been present in North India, South India and West India, more near to the market and now from Q1FY18, we are in East of India also. That has also helped us apart from savings on the logistic cost, and also in terms of good servicing at a much shorter lead time; the customer places the order and gets the material. That has also given us in terms of repeat orders from the same customers because our lead time in order servicing is quite efficient is what customers have been saying to us. So all these factors mixed together are the results that our EBITDA margins are better.

Ravi Sharma: In terms of debt, are you looking for any increase in further debt, for any capex or revamping of your existing plants?

Ashok Gupta: We do not think we are having any immediate plans to raise further debt.

Moderator: The next question is from the line of HetalGada from Elara Capital. Please go ahead.

HetalGada: So our EBITDA per ton has gone down very sharply and given that the steel price movement has been very sharp from June to August or September also, in HR itself the prices have gone up by 5,000 to 7,000. So for Q2 or going forward, do we think this can bring pressure on margins again because the price movement in steel prices has been very sharp?

Ashok Gupta: There have been reductions in the steel prices in Q1 as compared to Q4 which has affected our stock inventory valuation. In case you take care of that, then you will not be seeing so much of reduction in the EBITDA per ton. If this cycle gets reversed from Q1 to Q2, so whatever we have lost earlier, we will try to gain again now, make up the losses, so perhaps you will see better figures in this quarter

HetalGada: But if we keep aside the stock adjustment, with such a sharp increase will we be able to pass it on completely or will there be a little lag?

Ashok Gupta: It takes some lag but lag maybe only of two days, five days or seven days, lag is not months. Definitely there could be two-three days lag in terms of price increase and steel people now announce and we announce, to that extent we will try to absorb that minor two-three days or seven days difference. But normally we are able to pass through within a week or so.

Sharad Mahendra: I would also like to add that everyone is talking about the EBITDA per ton in the range of 2,800 or something in this quarter, I would just like to clarify while going through the numbers, there is other operational income of almost Rs.9.5 crore which translates into Rs.360 per ton of our sales in Q1. This is also from operations and this is being shown separately because of the change in the accounting standard, these are basically realizations and the benefits from our export sales. The exports benefits and other things which we get from the government in terms of incentives which is till now before Q1, has been shown separately. So if we add both, it comes to close to Rs.3,200 even in Q1.

HetalGada: Can we get the figures separately because if we see the other income portion, that has taken a huge jump; last quarter it was close to Rs.2 crore.

Sharad Mahendra: We will definitely share the details of this, but this is all related to sales only in major part, EBITDA, if we compare is close to Rs.3,200.

HetalGada: The Company used to mention the trading sales separately. So this time around, if I look at the presentation, the trading sales is close to Rs.28 crore, is the number right?

Deepak Goyal: Now, we are focusing on the manufacturing.

HetalGada: So the trading has come down significantly?

Deepak Goyal: Yes.

HetalGada: What will be the margins on this segment?

Deepak Goyal: It is 1% or 1.5%.

Moderator: The next question is from the line of ArunSubrahmanyam from Ampersand Capital. Please go ahead.

ArunSubrahmanyam: In your presentation,you have stated that this year the growth will be led by volumes, next year the margins will also participate and I also recall that in some of your earlier presentations or analyst meets you had mentioned that the margins can go up to Rs.4,000/ton. So just wanted to get a sense, is there any number in mind which you have for FY19/FY20 where the margins can eventually go to on a per ton basis?

Ashok Gupta: The very purpose of getting this new technology like DFT, inline galvanizing and all those things was that apart from volume we should be getting better margins, particularly in special products and we have seen this also happening, but to give a number to it, it will be difficult at any point of time because it will depend on so many other factors. But we are targeting that in months to come or years to come, we should be crossing Rs.4,000/ton. But when it will happen is something which we really cannot predict immediately. But they will slowly and steadily improve as much as we start increasing our production of DFT or sales will increase or branding will give us benefits. So they will inch up every quarter from Rs.3,300 onwards as our volumes for special products go up and hopefully maybe a couple of months or maybe a year, year and a half they should be closing to Rs.4,000 as well.

ArunSubrahmanyam: What is the bigger driver of margins – is it DFT technology or is it exports or is it branding?

Sharad Mahendra: In terms of a bigger driver in the margins, definitely will be the continued focus on the value added products which is Pre-Galvanized and GI Pipes wherein going forward we will be increasing the capacities also for these products which should add to our margins. Direct Forming Technology and some of the product range which gives us the exclusivity in the marketplace and presently which has not been available in the market is going to be the import replacement or maybe other Hollow Sections replacement which means that Hollow Sections in 300x300 for an example is being used either through imports or by some other variants, some other products being used for this application. So these are going to the new markets, and these are better margin products as compared to the normal products. So it is going to be a mix of branding, we are going to go ahead with the approach of technology focus, to our B2B customer segment with our Direct Forming Technology and in terms of value added products and other branding initiatives in the B2C segment, wherein we are launching the brands. So these are going to help us definitely going forward in terms of improving our volumes, supported with margins also in next 1.5-2-years.

Moderator: Thank you. The next question is from the line of AlokDeora from IIFL. Please go ahead.

AlokDeora: For this DFT technology, we had indicated that we would need to educate some of the clients about the benefits. I am sure that process was on since some time. So what has been the response like – are they looking to try the product or would they be taking a call after six-nine months or something?

Sharad Mahendra: Two of our lines got commissioned till last month and the biggest line which is 300x300 got commissioned this month. What we have experienced from the products available from our second line which is in Raipur or the first line which got commissioned in Hosur, we are happy to inform that we have been able to enter into segments which is basically the Agricultural Equipment segment, wherein a standard size which can be supplied by any producer from the conventional technology when we went and our technical team and applications engineering team has contacted customers.They tried and they were educated that maybe not this size, but this other size will be better for this application, we got the orders of special sizes which only this technology can make and successfully now we are supplying consistently for last maybe 2-2.5-months and we have got repeat orders also from these customers. So with this focus, we are approaching other bigger customers also like in construction equipment and other industries, like JCBs and caterpillars, etc, this has been very well accepted by many industrial segments.

AlokDeora: For this quarter and even for the next couple of quarters, would you be pricing the product slightly at a lower rate just to get this product through into the end customers and then maybe look at increasing the price and also after that would you be in a position to increase the price?

Sharad Mahendra: One is definitely that we are not going into the market with a lower price. Yes, some of the segments are price-sensitive, cost-sensitive, so we are going at the pricing in line with the market. Maybe if you want to say that we are charging premium, yes, we want to first introduce the product, let the customers experience, what we have told them theoretically on paper. Once they experience, customers have indicated that definitely going forward maybe six months to a year time, we should start getting the premium because they will change their entire design systems and everything and there will be a dependence on this particular product. So going forward, we see definitely it is going to be a better margin but yes, today we rather than focusing on margin, we are basically introducing the new products of this technology so that customers can experience the benefit.

AlokDeora: So this lag which will happen where you would start charging premium and you get some incremental margin from this, so that would happen from mid FY19 onwards, is that correct?

Sharad Mahendra: Sometime in FY19 we should be in a position not only with this but with the product offerings which we are giving maybe the 300x300 size or maybe 400x200 size, automatically this will be import replacement.Today, it is at a very high cost for importing these materials and also joining the few sections and making larger sections in many local projects. All these things will definitely give us better margins going forward and FY19 we expect the things to be better than what it will be in the current year.

Moderator: The next question is from the line of Sanjay Dham from Old Bridge Capital. Please go ahead.

Sanjay Dham: For DFT capacities that we have, what would be approx. capacity utilization where we would achieve breakeven?

Ashok Gupta: This year is only a year when we are going to commission, so the capacity utilization is going to be lower. Next year will be the first year when we will be having all the DFT facilities commissioned. For the DFT, as a whole, capacity utilization will improve. Next year, we expect around 30-40% capacity utilization.

Sharad Mahendra: Yes, slightly even better because some portion of the business will get transferred also from there, in terms of DFT capacity utilization, it may be slightly more than that number of 30% to 40%.

Sanjay Dham: Would it be correct to say that you would, in FY20, be able to get some reasonable free cash from this line of activity?

Ashok Gupta: Free cash from operations definitely is coming. We do not separate free cash from A-line, B-line or C-line, one organization - one free cash. But if you see totally free cash it will depend on how much the new projects we are bringing. I think you would have seen in the last few years, we have been focusing more on growth and creating free cash as a whole. Our operations give us cash but we normally tend to invest it again in the projects.

Sanjay Dham: DFT is where you are trying to create a new demand as you rightly mentioned, import substitution. But as we understand that probably it would also take some bit of exports along with domestic market to make this reach a reasonably good utilization level. So what is the progress on the international markets on this?

Sharad Mahendra: What we are focusing on is Middle East, Europe, USA and Canadian markets, wherein the acceptance of this technology, at our acceptable price level is there and Middle East is giving the logistic cost advantage and also a lot of activities are expected to be there in year 2018 and 2019, keeping in mind "Expo 2020" lot of activities are now coming up in Middle East, especially in Dubai. These are the markets which are going to be our focus because a lot of local few manufacturers are there in that market but none of them has this technology and the quality of products which this technology gives. So we have already started the supply that it has been appreciated. So these are the markets which are going to be our focus markets in the international market and we expect definitely for us to get an edge over competition with this technology.

Sanjay Dham: So you are trying to actually create a market and be the lead player in the segment both within India as well as be a leading player regionally. So whatever efforts you do either in the new JV or in the new technology of DFT, it should ultimately have an impact on the return on capital that you make. So you already have a very good fantastic ROCE. So the incremental capital that you allocate to these new ventures, when would they kind of, in addition to giving you newer segments creating newer demand, giving a toehold in many regions, also get us to that level of ROCE?

Ashok Gupta: Typically, any such thing which you do when you have new technologies or new products or new markets being created, it is just a time consuming process, it may take three-four years. So if you really ask me, we are trying to hasten the process by going for branding, communication, development, OEM, exports, all this. But even then it will take minimum two to three years for all that to fructify and our capacity utilization to reach what we would normally call at efficient level. It does take time, because it is a new thing and people are getting used to it.

Sanjay Dham: But do you think that in say a three year timeframe, you would be able to generate returns in line with your current ROCE from the new?

Ashok Gupta: Definitely, it will come. In three years it will be in line but after three years it will be much higher also. Because you see what happens the basic product is good and the basic product is good because today we have to compromise on our shirt size, whether it is 42 or 40, but I do not get 40.5, with this technology I will be able to give people 40.5 shirt size as well, I can give whatever he wants, people will like it, because then it just fits them perfectly. More and more people are today seeing not regular fit shirt but they are going for slim fit shirt because they look nice in that. Similarly, here we will be making something which just fits their requirements if you are making a warehouse, if you are making an airport, you do not have to go for next higher size or next lower size, and you can go for a size which just fits in your calculation. A) It saves wastage. It may save up to 5 to 10% wastage of the steel, which is big. Second thing is that it looks nice, it just fits in there. Of course, the best part is that once people start doing it, they will do more and more, it is possible that people will shift from regular sizes to customized sizes, more and more projects and projects typically have time to do the shifting. But yes, this change may take time, it may take two years or three years, let us see how much time it takes.

Moderator: The next question is from the line of Saurabh Patwa from HDFC Mutual Fund. Please go ahead.

Saurabh Patwa: Rs.36 crore of other operating income, if you add that then the EBITDA per ton increases by 300, but actually after adding this number it comes to Rs. 2,970. So just wanted to reconfirm the figure?

Deepak Goyal: In other income, it was Rs. 9.53 crore. If we divide from 265, it comes to Rs.360/ton.

Saurabh Patwa: So you are saying other income also needs to be added. I thought it was other operating income.

Deepak Goyal: Yes, in the other operating, it is the export advantage and EPC grants, etc.

Saurabh Patwa: So after adding all the operating income, EBITDA is still around Rs.80 crore?

Deepak Goyal: No, it is at Rs.88 crore.

Sharad Mahendra: We will share the details offline.

Moderator: Thank you. Ladies and gentlemen, as there are no further questions from the participants, I would now like to hand the conference over to the management for closing comments.

Ashok Gupta: I must thank all of you for such an interactive session. We are very happy. We are getting also some of the areas where we have to focus on, look into and one of them is definitely the EBITDA margin per ton and we can assure you that is our area of focus as well. We are working on it and I just like to request you to please have some patience. This area will also be giving us good results. It is taking some time. These are long-term plans, Branding, new product development, new markets does take some time. So I will just request you to indulge us in some patience and we will see good results from that front. With these few words, I thank you once again for your kind time.

Moderator: Thank you very much, Sir. Ladies and gentlemen, on behalf of APL Apollo Tubes Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.
