"Tube Investments Q1 FY-16 Earnings Conference Call"

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MANAGEMENT: **MR. L. RAMKUMAR – MANAGING DIRECTOR, TUBE INVESTMENTS**
MR. ARJUN ANANTH – CFO, TUBE INVESTMENTS

MODERATOR: **MR. KASHYAP PUJARA - AXIS CAPITAL**

Moderator: Ladies and Gentlemen, Good day and welcome to the Q1 FY-16 Tube Investments Results Conference Call hosted by Axis Capital Limited. As a reminder, all participants' 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 '*' and '0' on your touch tone phone. Please note that this conference is being recorded. I now hand over the conference over to Mr. Kashyap Pujara. Thank you and over to you Sir.

Kashyap Pujara: Hi, Good morning folks and thank you for standing by. It is a pleasure to have with us the management of Tube Investments. The management has been represented by Mr. Ramkumar Managing – Director and Mr. Arjun Ananth – the CFO. Without taking too much time, I hand over the floor to Mr. Ramkumar for his opening comments. Over to you Sir.

L. Ramkumar: Thank you Kashyap. Good Morning all of you, welcome to this conference call with us on the results of Q1 2015-16. Just I will take you through quickly the numbers and some qualitative factors.

We grew 4% on overall sales, 3% on the total income compared to the same quarters last year, at the EBITDA level the growth was 8.5%, at the PBT level the growth was 1.7% for the standalone company. Of course, consolidated did very well. The individual segments had different levels of performances, cycles and components we had a growth of 18% in turnover and 61% in terms of PBIT. There was a growth of 13% in the volume largely aided by the institutional sales. Though we started well in the first quarter the trade was virtually flat. In the case of Engineering division we dropped value by 10%. We must remember that this is a period of prices going down. The commodity prices have gone down and hence we had to pass on the price deduction to the various customers.

Our PBIT was affected; more than proportionately by 38% this is largely due to the impact of the fixed cost and the new plant depreciation, interest and other fixed cost. Having said that, we did have a drop of only 7% on the overall tubes volume, not much in the precision tubes but on the basic tubes and some drop in the strips in the Engineering division. In metal form products, the revenue grew by 3.2% and the profit before interest and tax, went up by 15%. We did have a growth in auto chains and Industrial Chains, we did have a growth in Fine Blanking as well as export of chains. We had a drop in the doorframes because of the models for which we are supplying but we have been awarded the contract for supplying the new model of Hyundai. We have made some progress in the other products like starter motor casings and the railway businesses.

Coming to the other divisions; major subsidiaries of the companies, financial services, basically Chola Finance improved its top line by 13.2% and its profit before interest and tax went by19.6%, continued to show an excellent performance. In the case of insurance, the top line growth was 7%

while the PBIT remained almost flat. So, subsidiaries have done well.. Shanthi Gears, we have been looking at better margin orders. We are seeing a lot of traction in terms of new customers; the results of which will happen maybe in the next two three quarters because some of them have a development lead time. The teams are working on various projects in order to take up the top line.

Overall if you ask me, bicycles have had good run in the first quarter and also aided by some more institutional sales and good work on the market side which includes new products, opening up the high-end stores along with cafes which we did in Chennai called Ciclo Café plus revamping our retail for the other bikes. We hope to see the rest of the year through on a good note. In the case of Engineering, we talked about the new project where we took some time to stabilize, we had to establish various sizes of tubes which will finally be rolled and then supplied to the hydraulic cylinder manufacturers and other sectors. We did have a little delay and we were doing a lot of trials in the fourth quarter of last year, I am happy to say progressively, the volumes are going up during the current year, especially in the first quarter we have been able to increase volume and we will take it up and we expect that by end of the 3rd quarter, we would have stabilized in terms of the budgeted volumes which we are looking at. Just to put things in perspective, we have been doing 600-700 tons per month on an average during the last quarter. It is expected to go up to something like 1800 tons at the end of the 2nd quarter, at the end of the 3rd quarter.

With this, we are also happy to say that many of our samples have been accepted. Now, it is under testing. They will have to put it under certain number of hours of testing after which we are hopeful that we will be able to get orders both from Indian and overseas customers.

Coming to Metal Forming division – Chains we continue to be strong. We have been gaining market share. We have been qualified for new models and we continue to be a dominant player here. In the case of fine blank components, again we are getting qualified for some of the best known Tier-1 suppliers in the world, both for India and overseas and hence we would see a growth in this particular segment. Doorframes, we continue to be the leader here. Wherever door frames are there we have been qualified by various auto OEMs. We have also been concentrating on motor casings and recently there has been a good pickup in the business with ICF, which is for coaches as against wagons. Wagons continued to be uncertain in terms of the timing, volume and pricing. We do have a plant dedicated for this, we use it as and when we get orders. However, the coach portion of the business seems to be picking up with the demand picking up and now we have a back log order. Shanthi Gears, as I already mentioned to you, the teams have regrouped to look at the customer service very closely, much faster service and we have also had a union settlement in the last quarter of last year. On the market side, we continue to get more and more new customers and get higher value products to be serviced by the company. So broadly, if you ask me, there has been a very good effort on the part of the Engineering division in the export side of the business. It is in work in progress because exporting to discerning customers and the automotive customers means you need to do your homework for a couple of years. This is been done in terms of getting our quality, etc approved. The initial supplies have started, so we do see that going forward, we would get more and more volumes coming from this segment.

So, overall if you ask me, this is the picture as far as Tube Investments is concerned and if you people have any questions, we will be very glad to answer. Thank you.

Moderator: Thank you. Ladies and gentlemen we will now begin the question and answer session. The first question is form the line of Dinesh N from Catamaran. Please go ahead.

Dinesh N: In the metal forming division at what rate did each of Automotive Chains, Industrial Chains, and Fine Blanking components grow?

L. Ramkumar: Industrial chains around 4 to 5%, Automotive Chains may be 1%, Fine Blanking 16%.

Dinesh N: And is there any set up available between the automotive and other parts of the metal forming division that is, how much percentage of the revenue is from Automotive Chains?

L. Ramkumar: As a matter of fact we are not able to disclose that being sensitive, we can answer any other question that you may have.

Dinesh N: Is this also sensitive that within automotive how much would be the OEM and replacement share broadly?

L. Ramkumar: OEM is huge.

Dinesh N: So, OEM would be like 70-80% of the total Automotive Chain?

L. Ramkumar: Yes, maybe 65-70%.

Dinesh N: And you told something about our new models which are the chains getting into, we have got some new model orders, can you give some color on that, any new model of ..

L. Ramkumar: We continuously keep trying, see all two wheeler companies launch new models and there is some change they want with the chain, so all of us manufactures have to submit a sample, it goes through the test, then the negotiation price, it goes on. We have been awarded orders for couple of new models have and so we are hoping that the models will do well, so that we can again improve our sales.

Dinesh N: You also mentioned that we gained market share in the chains division, did we gain market share in the replacement side or the OEM side or both?

L. Ramkumar: Both.

Moderator: The next question is form the line of Kashyap Pujara. Please go ahead.

Kashyap Pujara: Can you give us some details about your volume in Q1, what would be the bicycle volume for Q1 versus the comparable period last year?

L. Ramkumar: Q1 actual of now is 12.7 versus 11.2.

Kashyap Pujara: And how much would be institution in this year and the same period last year?

L. Ramkumar: This year is 2 lacs, last year virtually not much.

Kashyap Pujara: So, predominantly it is decent growth in this season. So, we have basically mentioned earlier that our long term strategy of bicycle growth will be more or less on the range of high single digits or close 5-8%, what is your outlook? Because you launched new models here in the bicycle side. You are trying to re brand, so can I understand, what is the long term growth outlook that you have on this division?

L. Ramkumar: Long term growth in overall bicycle industry will be low single digits if at all we will be happy because as you know a large portion of the standard market is coming down, which is a 35-40%. So, the growth is happening in kids segment, the growth is happening in high end segment, where new people are coming into cycling, maybe the older people, the people who want to do for fitness, they are more affluent people who like to use cycling as a lifestyle thing or for their own fun or sports or something like that. So, that segment is growing. So, if we talk about cycles of value about Rs. 7000-8000, it is growing but that is still not a huge portion of the market; that is growing 15-20%. If you take kids segment, it maybe growing by 7-8%. The traditional users of bicycle are both the rural as well as traditionally only after 13-14 years use bicycle, still years back, school children, etc. Beyond that, people left the cycle, but now lot of people want to come back to cycle, maybe in their 30s, 40s.Also, as a result of younger people wanting to take up more cycling with gears and other things and people are getting much more informed.

Kashyap Pujara: So, let us assume that if we grow a bit higher than the cycle industry is growing but since the special segment is growing faster where we have a strong positioning in, would not that imply that the margin for the cycle division should start improving going forward because that is any which way a higher contribution, the special segment?

L. Ramkumar: See, the kids cycle which also forms the major portion of the special segment is a very price competitive segment. If you want to increase the volumes substantially, which you can do so, it will be closer to the standards in terms of the margins, etc., because every kids wants to buy a new one. To improve the penetration into rural areas, you cannot price it very high, right?

Kashyap Pujara: Correct.

L. Ramkumar: That is what is happening today, there are even unorganized players competing with you, so you cannot price it high, We have some high price kids models of Rs. 3000-4000 and very few kids who will buy that. So, if it is not special, does not mean margin increase but in general what you are saying is right but we need to temperate with the proportion of kids, which is being sold at rock bottom prices, etc. So, that will definitely have an impact adversely on the margins.

Kashyap Pujara: So, what is your outlook for sustainable margins in this segment, we have seen a good improvement this quarter, obviously because the volume is reasonably strong and this is a seasonally strong quarter but otherwise what was your outlook on margins in this segment on a sustainable basis?

L. Ramkumar: I would like to trace that little carefully, I will get back to you with that number, we have done Q4 last year is 5.1, Q1 is 5. I think it should be around maybe somewhere 6-6.5%.

Kashyap Pujara: What would be your volumes in the Engineering front this quarter?

L. Ramkumar: Engineering, I think normally you ask for total strips and tubes and all that, I do not remember who asked, somebody asked. We did strips and tubes put together 51000 tons.

Kashyap Pujara: And how was this compared to same period last year because revenue drop would have been also because of commodity price correction?

L. Ramkumar: 54000 in the last year, not much difference.

Kashyap Pujara: So, essentially the core Engineering tubes are more or less running flat, I think the revenue drop is because of commodity price but the margins which have come off, Could you explain your new plant which has come on-stream, I am sure the interest depreciation there would be one of the contributing factors and the fixed costs, but could you give us when do we see stabilization here and when does the margins start showing improvement because of the new plant picking up?

L. Ramkumar: See, 1.5% of that businesses turnover would be the impact of margins due to the new plant not returning that is a negative as it is in the first quarter. So, progressively by second quarter we will get close to breakeven in that plant. As you said, at the end of the 3rd quarter, we would be out of the woods in terms of running in a positive figure.

Kashyap Pujara: Okay, so next quarter we will be breaking even and 3rd, 4th quarter onwards we will start showing traction there?

L. Ramkumar: Yes.

Kashyap Pujara: And in the balance sheet you have written that in the 8 quarters or so, we can expect full turnover from the new plant coming in, so what would that full turnover be?

L. Ramkumar: Right now we are running at 600 progressively going by the end of the year to 1800-2000. So, you have to go up to 3000-3200 tons per month. So, if we exit the year by 1800-2000, it will take one more year to ramp up to 3000. So, roughly you can say that is 8 quarters; 4 quarters of this year, 4 quarters of next year.

Kashyap Pujara: So, the peak tonnage would be around 40,000 tons, 38,500?

L. Ramkumar: Yes.

Kashyap Pujara: And here what would be my realizations because here the realizations would be substantially higher than the tube realizations that we have the core business?

L. Ramkumar: We will hold the answer till we really realize much more because we are dealing with a wide variety of customers, different sectors.

Moderator: The next question is from the line of Ankit Sancheti from Kotak Securities. Please go ahead.

Ankit Sancheti: My question again was on the same line; about the margins in the Engineering segment, once this capacity fully ramps up, but you have answered that you are not willing to share it, so. I leave it to you.

L. Ramkumar: No, I said we are not able to give a number on the margin, which is a frank answer but if you talk about the margin on the new business; will be higher than the existing business. That is the way it is planned and we continue to hold the same view.

Ankit Sancheti: So if I look at Q1 FY15, your margins in Engineering segment, that EBIT level was 6.5%, so this quarter it has fallen down so if I go in Q1 of FY17, which is exactly 12 months from now, can we have an Engineering division where you will make more profit from the new plant and we can have a margin which can be in the range of 7-8% which was the margins one year back. Is this a reasonable assumption or you want to quantify it?

L. Ramkumar: Yes, it is a reasonable assumption.

Ankit Sancheti: And there after it should move close to double digit?

L. Ramkumar: Yes, it should definitely move up that is what I said, I am not able to say now. We would rather get a mix of products' customers, finalize and then we should be in a position to tell you, yes I think it will move up by a percentage.

Ankit Sancheti: Second thing was; on cycles the margins which we see, close to 7% in this quarter. Was it driven more by foreign commodity prices or no?

L. Ramkumar: The combination of commodity price drop, and mix of specials and higher volume on institutions also. That also gives you a good leverage on the fixed cost with the combination of all these things.

Ankit Sancheti: So in the fall of the commodity prices, have you seen any player reducing prices or have you reduced the prices of cycle?

L. Ramkumar: Everybody is reducing prices; we are being the last to do that.

Ankit Sancheti: Has the reduction is in line with the falling RM prices or you retained some benefit.

L. Ramkumar: Yes, it is difficult to say but always there is an endeavor to retain some margin.

Ankit Sancheti: And another thing is, in terms of overall mix in bicycles. How much will be kids and high end for you, as an overall sales on a yearly basis?

L. Ramkumar: I think it will be some 15%,-20%. 17%-18%, I think.

Ankit Sancheti: So roughly, 17%, 18% is your kids and high end put together.

L. Ramkumar: That is right.

Ankit Sancheti: And what would have been say, 3-4 years' back? It should be less than 10% or, it was 15% and it has gone to 18% only.

L. Ramkumar: I wish I remember all the figures. The percentage would have increased, that is all I can say.

Moderator: The next question is from the line of Srinivasan from UTI Asset Management. Please go ahead.

Srinivasan: can you talk more on the wagon part of your metal forming division, like there is a lot of buoyancy on Railway, so how geared are we to capture the growth and what has been the growth in the current quarter and last year. And you really see the business booming in a big way, a couple of years down the line?

L. Ramkumar: As far as wagons are concerned, we have not even seen a normal growth. So, overall there is a lot of buzz around Railways, lot of things are happening in Railways, and we also keep reading about it. But we have not seen anything on the ground because fundamentally the release of order for a particular year itself does not take place on time and hence there is no clarity about who will get how much business? First, the wagon builders should get the business for wagons and then they will place orders on the people like us, who supply the various parts. So, even I think, for the last year it is still being held, nothing has been released.

Srinivasan: If you could just tell me; what would have been the peak turnover of this division two to three years back?

L. Ramkumar: Peak was higher than Rs. 100 crores.

Srinivasan: And now it will be less than half.

L. Ramkumar: Rs. 59 crores I think last year we did.

Srinivasan: And we have capacity to go back if your demand really pick up and they are saying.

L. Ramkumar: We will do much more, we can do double of that also, if we do continuously every month. We have much more capacity but please remember from the time, when we did Rs. 100 crores now the prices have also fallen very badly.

Srinivasan: And secondly, on the insurance side I just had a question what would have been the combined ratio and investment return in the quarter? Are we kind of closer to breakeven on the combined ratio or we are still running at 105-107%.

Management: Combined ratio was 107%.

Srinivasan: And the investment returns?

Management: 9.3%.

Srinivasan: And this combined ratio do you see some improvement over the next 3, 4 years to more say 100% or even a positive territory or we will have to work with this model of 107% and hope to get more returns on the investment side?

Management: There have been a couple of quarters in the past where we have had combined ratio of 101%, 100%, even we had 99% in one quarter, so obviously it is a function of the expenses through acquire customers versus your assets and premiums. We don't want to give guidance on this number but one would be fair to expect that the combination would come down over a period of time.

Srinivasan: Secondly, what is the plan of investing in this insurance in the current year? We have lined up any investment or it will fund for its own growth?

Management: I think they are fairly self-sufficient.

Srinivasan: So we do not need to put any money into this business. And sir, any clarity on the FTI because it is now notified, so any clarity on the timeline as to when we will do it or whether we will do it at all?

Management: Really not able to say because nothing is clear.

Srinivasan: And sir, we had also working on some restructuring by hiring of all the financial services into an entity, so are we progressing on that or it is just in limbo?

L. Ramkumar: Nothing has happened so far, it is all in concept stage.

Moderator: The next question is from the line of Dinesh Shukla from Sharekhan Ltd. Please go ahead.

Dinesh Shukla: My question is again related to Insurance business; now our solvency ratio as on FY15 was 1.59x so given that he growth prospects are better in FY16, still we do not require any capital infuser in the company?

L. Ramkumar: We do not require capital infuser this year.

Dinesh Shukla: Okay and IRDA is planning to rework on the Bancassurance guidelines, so will it have any impact on your existing Bancassurance types?

L. Ramkumar: No, we do not see anything

Moderator: The next question is from the line of Pankaj Tibrewal from Kotak Mutual Fund. Please go ahead.

Pankaj Tibrewal: Can you take us through what things have been done at Shanthi Gears; it has been some time now, so how should investors like us look at Shanthi Gears investment? And Sir, second question is; if you were to look 3, 4 quarters ahead, what are the bright spots on your portfolio, what are the not so bright spots in your entire business portfolio?

L. Ramkumar: That is a very high level question; let me try to answer very boldly. First one is very specific, down to earth, second one is a little at a helicopter level but I will attempt both. See as far as Shanthi Gears is concerned; the last year finally what we ended with was not good. We had a drop in margins. While we did increase our order book during the year, we had to resort to some price dropping and getting into some very close competition that resulted in margin's pressure. But I can say some of these things which should give us more better results in the quarters to come. Ever since the last quarter of last year itself, we have put a lot of controls on the margins and we said we will sacrifice turnover for margins. In case, we do have a little lower turnover also. We will take some time to build up the higher margin business. Since then, I should say the margin on the order book has been steadily increasing and slowly I think, maybe we still have some of the old margin things. By this quarter, we will have the low margin things going out because it takes some time to execute these orders and sometimes the customers are not picking up after we finish because of the market conditions and the situation in the country. So, one thing is we expect that margins should steadily go up. There is a very good; the emphasis on cost reduction. Though it may not make a huge impact in terms of the percentage, will keep the cost under check both the fixed and the variable cost. The third thing again, you may not see in any P&L but it will reflect over the years over the months is the execution. The execution has improved substantially in terms of audit to delivery kind of ratio. The fourth thing we are doing is we have been visiting lot of customers who have not approached in the last couple of years, who are major customers, who would give us bulk orders over a period of time which requires very specialized machineries like what we have. These are all work in process and these all have a 6 months' to 9 months' development lead time. So I am hoping that by end of this financial year. We will have some of these customers coming into our fold in terms of what you call; qualifying us and the orders start coming from the next financial year. Overall, if you ask me what is the outlook, what investors like you can look forward, I would think and I wish it happens also the way I think now is progressively we should see performance improving quarter after quarter and bringing in some stability in the margins, etc., and then taking it further as we go over to the next year.

Pankaj Tibrewal: What is the order book at Shanthi right now and what was the order inflow this quarter?

L. Ramkumar: Order inflow the current year is Rs. 40 crores, the first quarter and pending order book as of June 30, 2015 is Rs. 81 crores.

Pankaj Tibrewal: And this is to be executed over the next few months and I believe short cycle order….

L. Ramkumar: Not all Rs. 81 crores will be done immediately; Some are short, long lead time, etc. Some Customers give orders for the whole year.

Pankaj Tibrewal: So obviously the execution improves the margins because it is a high operating leverage business, so it is on to the margins at the bottom line that is correct?

L. Ramkumar: Correct. Plus also there are order books in the same quarter for delivery in the same quarter also short lead time orders. It has to be done in the beginning of the quarter. Coming to the portfolio of TII, I see a lot of bright spots everywhere with little bit of help from the economy. One is the bicycle side where I think we have our share maintained and improved. Definitely our new products, the high-end products have done very well. So if we get our act well we can see a good growth there. At the same time, we are also in the process of rationalizing cost because the bulk of the business is very cost sensitive or price sensitive, if we control our cost further, I think we should see a decent profitability and a reasonably good growth in the top line. We have started some efforts in exports in the kids segment, we have done reasonably well, we are also looking at other orders, if that fixed up again I think we will have some more volume coming from the export side. The Engineering side, I think the new plant which we have incurred some cost in the last few quarters and the current quarter; as it starts picking up I think our top line and bottom line will improve, plus we are also doing a lot of work to improve the value-added portion of the base business and also tying up closely with the customers. Apart from exports I talked about, the two-wheeler Tier-1 suppliers in the ASEAN and other regions, if that fix up, the exports will also pick up well and this will give us an additional volume and growth. In the case of Metal Forming, Chains – as I told you we are a dominant player, we are growing both in the OE and the aftermarket segment. There are some new breed up chains we need to develop we are working on them. Once we get them right I think they will get into the market; maybe it could be import substitution or taking shares from somebody else. So that will add to the value. And in the Fine Blanking business again is in a very initial stage in the country. People are wanting to buy more and more from India as the Engineering and the facilities are good. This could again auger very well for us. On The Metal Forming side – while the Doorframe business is dependent only on cars with doorframes we still are a dominant player we are looking at a few options there in terms of doing motor casing and few other things. So that also I think in the quarters to come should go up. So I think there are lot of areas where we see avenues for growth, consolidation, and improvement in the market share apart from margins.

Pankaj Tibrewal: So when most of the businesses are probably the worst you sensed it to be behind because we are quite disappointed from the Engineering side till the ramp up has not happened and it has been some quarters now where the ramp up which was expected has not happened so what is the real problem, if you can help us understand that?

L. Ramkumar: When you put up a new Tube plant with different sizes, thickness, the strip is taken and rolled in the tube in several stages. So you have to get the perfect cylinder and the weld line should be correct, etc. Sometimes it takes some time to get all the sizes correct, we are not making one size, we are making different sizes. So you will have to check for various sizes, the loads, the various things, speed, and other things. I think that has taken a little longer than we expected, we also thought that some improvement has to be done on the mill in terms of strength as we are doing this. I think the good news is we have almost done with that now. So we are more confident of rolling it in large volumes whatever is required. And process – we have also been able to do some samples because these are very critical tubes. You have to give it to the customer, customer will have to put it on the off road vehicle or whatever application, run it for few months or few hours in the week and then get back and tell you, it is okay, you go ahead. That process is on. I must say that it has also been quite favorable towards us. So this is the story as far as engineering new project is concerned. This is definitely has had an impact on the research of Engineering as well as TI as a whole.

Pankaj Tibrewal: Absolutely. These things you think are now behind you and probably most of the things which you know, are talking about ramping up has taken into consideration the improvement.

L. Ramkumar: Yes, we believe so.

Moderator: Thank you. As there are no further questions, I would now like to hand the floor over to Mr. Kashyap Pujara for closing comments.

Kashyap Pujara: Thanks everyone for being on the call and thanks Mr. Ramkumar and Arjun for being there.

L. Ramkumar: Thank you, thanks all of you.

Moderator: Ladies and Gentlemen, on behalf of Axis Capital Ltd. that concludes this conference. Thank you for joining us and you may now disconnect your lines.