"Tube Investments of India Limited Q2 FY15 Results Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Tube Investments of India Q2FY15 earnings conference call hosted by Axis Capital Limited. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing * and then 0 on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Kashyap Pujara of Axis Capital. Thank you and over to you sir.

Kashyap Pujara: Hi, good morning everyone and thanks for being on line for the Q2FY15 earnings conference call of Tube Investments. It gives me great pleasure to welcome the Management of Tube Investments. We are represented by Mr. Ramkumar who is the Managing Director and Mr. Arjun Ananth who is the CFO. Thanks everyone and without taking too much time, I now hand over the floor to Mr. Ramkumar. Over to you sir.

L. Ramkumar: Thank you Kashyap. Good morning to all of you and thank you for making into this call. I will take you through the details of our standalone and consolidated performance for the quarter ended 30th September 2014.

We ended the quarter standalone at 1,006 crores against 900 crores for the same quarter last year, a growth of 11.2% over the same quarter previous year and a half year growth over the previous half year is 12.2% in revenue terms. Coming to profit from operations before other income, finance cost and exceptional items, we ended at 62.46 crores against 60 crores of last year. There was a small dip in the percentage from 7% in the previous year to 6.5%, partly due to depreciation and also some costs absorbed during the period due to the new project which has come up at Tiruttani. In the half year period, we are at 6.4% against last year 6.7% to the turnover.

Coming to profit before finance cost and exceptional items, again we are almost around the same level as last year, 72.25 crores last year and 71.42 crores this year and slightly better than the half year, the last year 126 crores is what we achieved and the previous half year we ended up at 131 crores. There has also been a small dip in the margin at 6.9 versus 7.5, partly due to the depreciation and certain other costs and also pressure on input margins. Profit before tax, we ended up at 36.1 crores against 41.23 crores partly due to higher finance charges as well and half year, we ended up at 62.82 crores against 64.79 crores of the previous half.

Coming to the consolidated results, you would have seen that we ended up at 2,484 crores of topline against 2,222 crores of previous year same quarter, a growth of 11.2%. Also the half year mark, our growth in consolidated revenues was at 11.7%. The profit before tax also had a healthy improvement to 239 crores current year second quarter against the same quarter last year at 200.89 crores. The margin also is better in terms of percentage. The half year mark, we have reported 451 crores consolidated PBT versus 398 crores last time, again 0.1% more in terms of margin.

I will quickly take you through the segmental performance of the various segments. First is standalone segments, I would start with TI Cycles, we had revenue growth of 5.3% in Q2 11.3% in H1. In engineering, we had a revenue growth of 16.3%, half year at 14%. Metal formed products, in the current quarter we had a growth of 11.8% over the same period last year, the half year growth being 10.6%. These are all as far as the standalone segments are concerned. Again we did well in the subsidiary companies of financial services. In insurance, we grew the topline at 8.9% for the quarter and 8.7% for the half year and other financial services is basically Cholamandalam Investment and Finance which is 14.5% for the quarter and 14.5% for the half year. We did have a drop in turnover in Shanthi Gears, for the quarter there was a drop of 9.5% and the half year mark, the turnover drop is 3.9%. You would have also seen the consolidated segment results in terms of profit before interest and tax. Cycles grew 4.8% in Q2 against 14.2% half year mark. Engineering, there has been a drop partly due to the absorption of the higher depreciation as well as some costs in the new plant which is just being inaugurated on 31st of October. Metal formed products had a growth of 5.3% in the PBIT for the quarter against 12.8 for the half year. There was very good growth in Insurance at 144% during the quarter and also 79% for the half year. And other financial services which is basically Cholamandalam Investment and Finance also, in a difficult market we had growth of 8.3% for the quarter, 5.8% cumulatively for the half year. However, we did have a drop in profits at Shanthi Gears. We dropped by nearly 69% and I will be explaining to you. There is almost a similar number when we came to half year. We would explain to you as to why this drop has occurred.

Now going into the individual segments and I think many of you are interested in the volumes, so I will run through the volume growth. In the bicycle division, we had almost a flat performance, we did not have much growth. There was some improvement in some of the special category especially in the premium category. We also had a growth in the institutional segment; however, there has been a drop in the standard segments in the market place. The market was also a little sluggish in the second quarter compared to the first quarter. Cumulatively for the half year, we have grown by 5.3% in volume terms.

In engineering, we grew in strips by 15% for the quarter and 11% for the half year. Overall in tubes including exports, we grew by 11.6% in volume terms cumulatively at 10.2% for the half-year mark. Door frames, the passenger car market has not been very good. Of course our fortunes are linked to those models which use door frames which is basically Hyundai, some of Tatas and some very few models of Maruti and General Motors. There has been a drop in volume in the door frames around 11.2% in the quarter and 11.6% in the half year mark. However, in the metal-formed section, the chains have done exceedingly well, propelled by the automotive growth basically the two-wheeler. We had grown in the quarter by 28% and the half year mark by 26% in volume terms over the previous year and also 6% in the quarter in the aftermarket and 11% the half year mark. We also had reasonably had good growth in fine blanking and engineering class chains which we do sell. The industrial chains also grew well at 12% in the quarter and 17% up to half year. There has been some improvement in the growth in exports which is 12% during the quarter and 2% in the half year mark.

Coming to Shanthi Gears, we have seen a drop in the turnover. One of the things we want to say is the market has been very difficult. There has not been much pickup in the infrastructure industry on which our company is totally dependent on for the gearboxes. As you know, the mines were completely closed during the last few months and yet to be re-opened with fresh announcements etc. It is one of the segments mines and consequently as a result, power and other segments which are connected with this industry; however, the good news is that we could book more orders due to some aggressive pricing. So at the end of 30th September, our order book stands at 89 crores versus 74 crores at the end of June and 64 crores at the end of March. During the period Q2, we booked around 54 crores of orders against 34 crores in the same quarter last year which meant the growth is something like 57%. Cumulatively for the year for the first half, our order booking has been higher at 36% more than the previous year and then we booked an order of around 102 crores, we booked only 75 crores.

Now coming to the drop in turnover in profitability, so we did have a very tough quarter but we started stepping up the order book. Many of the places, we are regaining our lost customers. Given our price premium, we were not able to charge the entire premium which we used to. As an entry strategy, we had to get back to lost customers with lower prices, hence you see a drop in margins. In fact, the order completion is also expected to increase in the third and the fourth quarter because most of the orders booked in the last quarter require a lot of engineering and other kinds of inputs from customers by which it will be finalized and then taken up for productions. The most of the orders booked have been in general engineering and a few others areas, cement, sugar, power etc. have not been very high as it is normally expected in this kind of business.

Talking about one of our subsidiaries in France Sedis, again, the good news is on the topline in the Q2 current year versus previous year, we grew by 11%. Year-to-date, we grew by 18% over the previous year. However, they also have been affected by the margin during the quarter. There has been a drop of 15% in the margin for the quarter; however for the full year, we have done well, I mean, I am talking about EBITDA margin. We have grown over the previous year same time at 32% year-to-date.

I shall also mention to you the performance of the standalone companies, you know about Cholamandalam Insurance which I already mentioned about insurance growth and profitability. So if you have any questions, I can answer specific questions on this. Normally, there is also a question about how much is the CAPEX we have spent? So far during the quarter, we spent 29 crores. Cumulatively, we have spent something like 80 crores and we hope that we end the year something like 160 crores of CAPEX. The other usual question also I thought I would cover, what is our debt-to-equity ratio? Our long-term debt-to-equity ratio at the end of 30th September is 0.82.

A couple of things I want to mention to you is that we inaugurated the large diameter plant at Tiruttani on 30th October. Trial production is going on and the plant has come out very well. We had many customers and many of the overseas suppliers who visited the plant for the inaugural function. The uniform opinion was that the facility is state-of-the-art and with various customers giving the trial orders and also we need to set up the plant for the various sizes, we hope in a couple of months we will be able to commence commercial production and full production in a way that we can start meeting the customer's requirement. I must say the initial response from various people who visited the plant is definitely encouraging. This is what the story from us and if you people have any questions, we will be very glad to answer. Thanks.

Moderator: Thank you very much sir. Ladies and gentleman, we will now begin the question and answer section. Our first question is from Kashyap Pujara of Axis Capital. Please go ahead.

Kashyap Pujara: Just wanted to ask you couple of follow-up questions. Firstly on the insurance side, we have reported a very stellar set of numbers during the current quarter and while the headline growth apparently in terms of gross return premium is still close to 9% which is lower than we used to grow but the profits have really scaled up. So is this trend of things to come wherein we can look at reporting at least per quarter, the current run rate of profits? Is it possible that we can look at current trend being sustained?

Arjun Ananth: Kashyap, I will just add as of the same period last year if you recollect, we had the motor pool losses that we had provided for on a pro rata basis which was around 28 crores last year YTD.

Kashyap Pujara: Correct, absolutely.

Arjun Ananth: The motor pool losses are not there this year. If you take the PBT after motor pool losses, what was 55 crores last year YTD is now 100 crores this year. So actually you should compare 83 crores to 100 crores.

Kashyap Pujara: Fair enough. So basically this current growth rates in that sense will continue and second would be about the absolute increase in the pricing? I think there were 2 rounds of price increases that happened on the motor pool front, so are we seeing further traction in terms of price increases for the third party motor pool cover?

Arjun Ananth: So the third party premiums, I think that is what you are asking about?

Kashyap Pujara: Yes, the premiums, third party premiums.

Arjun Ananth: From April 1st onwards, we have seen increase in premiums of private cars between 15 and 20%, in commercial vehicles somewhere close to 10%.

Kashyap Pujara: Secondly what would be the current combined ratio currently at?

Arjun Ananth: For the second quarter, it was below 100%, at 99.7%.

Kashyap Pujara: That is damn good which means you are already virtually making underwriting profits in that sense and just lastly on the insurance would be what would be the size of the investment book currently?

Arjun Ananth: The size of the investment book currently is 3,005 crores at the end of September.

Kashyap Pujara: Okay great and coming to questions on the volume front, as a followup could you just give some sense of volumes as to where we are on the volumes? Like, how many cycles we did this quarter I mean?

L. Ramkumar: Almost the same as last year I said the number wise.

Kashyap Pujara: In tube front, if I were to just look at the total tonnage of the engineering division, strips and tubes combined?

L. Ramkumar: Stripes and tubes combined for the quarter is 57,000.

Kashyap Pujara: That is great. And lastly, if I recollect the large diameter tube plant was essentially a substitute to imports that were happening in the same product segment and the project was conceived probably at rupee was even at a favorable point from yours at a cheaper point from, I think it was close to 50 USD. So essentially I do not see any reason why we would not be able to scale up provided we get the product right. So are we seeing enough customer enquiries to basically ensure that we run at optimum capacity utilization over the year?

L. Ramkumar: Yes. We are definitely seeing a very good traction for that and of course, the key for our success is going to be quality because the equipment everything is there. So we have all the guys from Germany, Italy, or Japan with us to train our guys. I think we will be stepping up as we go long, we do not see any problem.

Kashyap Pujara: Sure. And also I think the margins in this product were much better than the traditional segments, so any sense on that, if you could just throw some light.

L. Ramkumar: Margins are definitely expected to be better and if you are asking how much let us wait, will tell you.

Kashyap Pujara: Fair enough. And lastly on the total, what could be the asset turns that one can expect here?

L. Ramkumar: Actually we are expecting almost close to 2, may be it will be in a year 2 or 3 depending on how the market picks up, most probably 3, I would say conservatively.

Kashyap Pujara: Yes, 2 or 3.

Moderator: Our next question is from Nilesh Gandhi of Destimony Securities. Please go ahead.

Nilesh Gandhi: I have a question on Shanthi Gears front. Last quarter management has told us that in other manufacturing costs, there was some one-time legal settlement fees that were included. So do we have anything one-off in current quarter's number?

L. Ramkumar: No, the legal settlement is not employee. We have an old outstanding issue with one of the potential customers. The legal case was going on. In order to get more business, we told them to give up our claim. So what all we had in the books, we had to write-off around 3 crores. In the current quarter, there is no such one-time item.

Nilesh Gandhi: Okay, thanks for the clarification. Sir, could you please tell us what is the capacity utilizations at Shanthi Gear level?

L. Ramkumar: It is not very different from what we have been telling you, maybe around 35 – 40%.

Nilesh Gandhi: Typical order completion time is same**,** 3 or 4 months.

L. Ramkumar: Yes, you can say that. The problem is there is a high variety. So sometimes when the non-standard products which is what we predominantly do, then customer also takes time. So it is like they place the order. I think many times, it takes 6 to 8 weeks for the customer to freeze the exact specification and that period can be, this is also sometimes flexible. After the customer has completed specification, we can deliver in 8 to 12 weeks.

Nilesh Gandhi: So sir, as we seeing that there is an increase in the order book and so you mentioned that you bided for at a lesser margin that is why you won the order. So say let us assume a scenario where the economy picks up in 2 quarters. Are you confident about regaining the margins that you are saying that you had to wait.

L. Ramkumar: Definitely. Beyond this, we thought us being fairly in good position and we have to catch up upon execution. We are definitely putting a lot of filters for margin now. So that our factory will be kept busy with all these orders and we will now look for specific areas where definitely margin improvement should take place. Like you said when the economy picks up also, I am sure when the demand picks up again, the prices also start going up. So we are very hopeful and confident that margin should only go up and not stay at this stage.

Nilesh Gandhi: Okay sir and that is great. Sir, on raw material front, do you expect any rise in the cost

L. Ramkumar: Not very significant that we cannot cover from the pricing.

Moderator: Thank you. Our next question is from Shreya Chaudhari of Path Pioneer. Please go ahead.

Shreya Chaudhari: You mentioned something about combined ratio being 99%, what was that exactly? I actually missed that.

Arjun Ananth: Combined ratio is basically an indication of how profitable the underwriting business is in the insurance business. So if it is below 100%, it means you are covering the expenses with the premiums that you got.

Moderator: Thank you. Our next question is from Prashant Shah of First Consultant. Please go ahead.

Prashant Shah: Just wanted to check if still any update on the restructuring plans. I guess last time we spoke that there was some talks about restructuring of the business.

L. Ramkumar: Nothing much has happened since we spoke last whatever we told you, I think it stays good.

Prashant Shah: But, will the insurance business be monetized given that the policy is more conducive now? The overall policy structure is more conducive.

L. Ramkumar: I think this has been on the annual for 12 or 18 months or whatever. So we donot want to say anything till we actually see the bill being passed in both houses of Parliament, etc. So let it happen, we are keeping all the options, we are looking at all the options. In the appropriate time, we will definitely let you know.

Moderator: Thank you. Our next question is from Kashyap Pujara of Axis Capital. Please go ahead.

Kashyap Pujara: Mr. Ramkumar, I just wanted to take your sense on the overall automotive growth outlook. I mean, considering that our standalone business has a very strong linkage to the fortunes of the automobile sector, two-wheeler, four-wheeler put together, so how are you reading it in terms of the underlying demand for passenger cars and two wheelers and how do you see that going ahead. I agree that this quarter has been soft on four wheelers and two wheelers are showing some traction which is reflected in the chains business, but overall medium-term outlook what is your sense as to how the situation on the ground is shaping up?

L. Ramkumar: See, two wheelers as you said has a very strong growth actually. We are being kept busy by them wherever we are supplying to them from chains, tubes etc. and we also see this growth continuing. Passenger cars has been single digit growth, may be a lot of competition in the market etc. Medium-term, if you say whatever macroeconomic signals and various other factors, we see all that were to come through on the ground. I think passenger cars will pick up. Slowly, commercial vehicles also should start picking up from a negative growth, but I think that will definitely impact our business very favorably. Medium term if you say, I will talk about may be 1.5 to 2 years. We do not know about the coming 6 months we hope something happens but I do not think our optimism is still there. It is not that because this quarter or next quarter is not going to be good. We are looking at that there will be a good growth and whatever is being said would happen.

Kashyap Pujara: Fair enough. The point is that if I were to look at your passenger car, door frames per se, while clearly we are operating below our capacity levels. So are we pushing for price increases considering that the volumes which probably we would have anticipated would be working out to be tad lower or how is that shaping up? Are you seeing some traction where customers are accepting price increases? Are you able to push it gradually? What is your sense on that? And second is about the fine blanking business, it has been growing from strength to strength chains as well. I think you had ramped up capacity in chains to an extent, can we sustain the current growth rate that we are seeing in that segment.

L. Ramkumar: I will talk about the optimistic portion first. Chains is definitely wanting to increase more capacity. Fine blanking is doing well because there is a lot of indigenization going on or people were using cheap metal or using fine blank components or people are buying from India for their overseas operations. As far as the door frames are concerned, when we talked about price increase from automotive companies for volume, I can only invite you to join our team to negotiate and you will get the benefit as much as we do because this price increase in automotive is not going together in the current position. Even to get a raw material price increase, we have to work very hard and so I do not think anybody is going to flex the volume and then give you a higher price increase. We are trying to look at cost reduction, we are trying to see that our investment is minimum, we are trying to get the tooling done by our specific models risk is there. These are the things we are attempting in order to limit our exposure. Beyond this, it is very tough to get more and more from them because for example, you talk about Nano, we have plant only for Nano. You know how much is the production in the last quarter, virtually nothing. So we are trying to see what other use we can make of these assets. Now going and asking them for a price increase, what increase they will give. So I think this is where the problem is. Unless the volumes pickup, I think this is a serious problem for everybody.

Kashyap Pujara: So the key thing to watch out is the growth in the automotive, passenger car grows and especially the models that you are catering to.

L. Ramkumar: Yes, specific models, not overall automotive growth can help us may be in tubes because we supply to all companies, but door frame, there is only one single vendor for each model. So we should be connected with that model actually for having the benefit of it.

Kashyap Pujara: But then again here in this case, the tooling is basically provided by the OEMs. So essentially the model does not do well, the tooling is at there I mean.

L. Ramkumar: You cannot do zero, some they will provide, some you have to have on your own, the discussion keeps going on.

Kashyap Pujara: But can we use the same facility for other models is the question I was trying to lead at by replacing the key tooling

L. Ramkumar: Tooling cannot be used at all because tooling is exactly to the specification of the car. Machinery, we can use like we have stretch bending, we have roll forming. These are very generic machines. So tooling, you will have to keep on changing actually.

Kashyap Pujara: Fair enough. So essentially the point is that in the overall engineering and this business, we have reasonable operating leverage. Once volume picks up, we can see a healthy growth in margins here.

L. Ramkumar: That is true.

Kashyap Pujara: And in the cycle business, I think what my question was for this business was about the ad spend. Over the last quarter or so, we did notice that we have spent more on promotions and advertising which is good, but are we seeing the same intensity going ahead as well I mean.

L. Ramkumar: Idea is to continue that. We made a start. I hope some of you have seen the ads also, apart from seeing it in the P&L in terms of the expenditure. We have seen very good response. We knew that for a while we are not being on the air and during the various seasons, for children we have done in that season and for adults, we have done a little later. It has paid good dividend. Dealers are very happy. There are more footfalls seeing the ads, you can assume that our goal is to continuously keep improving on this in order to get more traction.

Kashyap Pujara: Fair enough. The supply chain glitches are also now behind us, so essentially we will be able to see a pickup in specials as a segment for us.

L. Ramkumar: Yes.

Kashyap Pujara: So what would be the sustainable growth for the cycles business if I were to take a three-year horizon?

L. Ramkumar: Our business or industry?

Kashyap Pujara: For the industry and obviously for our business.

L. Ramkumar: See the standard segment is going down which is now I think may be today 40% of the total, the balance 60% if I divide it into kids, adults, and high end. The kids again, there will be a good growth which may be, I think, the balance will be 25% of the specials, 25–30%. In all the adults, also there will be some growth of 8 to 10%, the boys segment MTB and all that. The premium segment which is a very much smaller segment which is of 15 to 20%. This is for cycles which are costing above Rs. 7,000 – 8,000.

Kashyap Pujara: So essentially for us, can we expect 8 to 10% kind of a growth in volumes that can come through blended?

L. Ramkumar: It will be good if we can do that.

Moderator: Mr. Pujara, there are no further questions from the participants. Would you like to add a few closing comments?

Kashyap Pujara: No, that is all. Thank you so much to the Management of Tube Investments to spare time for the conference call and thanks to the participants who have joined in to attend the call. Since there are no further questions, we can look at ending the call right.

L. Ramkumar: Thank you Kashyap and thank you all the participants.

Moderator: Thank you. On behalf of Axis Capital Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.