"JK Tyre & Industries Q2 FY17 Results Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the JK Tyres Q2FY17 Earnings Conference Call posted by SBI CAPS Securities Ltd. As a reminder, all participant lines will be in the listen only mode and there will be an opportunity for you to ask questions at the end of today's presentation. 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. Mahantesh Sabarad from SBI CAPS Securities Ltd, thank you and over to you Sir!

Mahantesh Sabarad: Thank you Stanford, good morning. Welcome to the Q2FY17 Post Results Conference Call of JK Tyres. We have with us the management of the company represented by Mr. A.K. Kinra, he is Director Finance; Mr. Sanjiv Saxena, VP Corporate Accounts; and Mr. Kamal Manik, Associate VP Finance. Welcome gentlemen. I will now request Mr. Kinra to begin the call with his comments. Over to you Sir!

A.K. Kinra: What I will do is, I will just briefly give the financial results for quarter and for the half year and then we can take on the questions. You have seen this quarter the company has achieved a gross sales and other operating income of 2070 Crores and an operating profit of 394 Crores. The profit before tax for the quarter is 148 and the profit after tax is 106.18 Crores, the comprehensive income put together which compared to the preceding quarter was slightly better, but keep in mind that these quarter volumes are up but over the corresponding quarter the selling prices are down by as much as 8% and over the previous quarter they were down by 2%. Secondly even this quarter compared to the last quarter though the raw material was slightly higher, the raw material prices which had seen a little dip in the last few months has again come back and even today there was an article in the newspaper that the rubber prices are now almost running at about eight months high. Now, given this background I think it was reasonably a good quarter and a good half year. For the half year, the total turnover of the company is 4021 Crores with an EBITDA margin of 757 Crores as compared to 621 Crores in the last year. At the PBIT level the profit is 400 Crores as compared to 393. So, I think this year is moving so far in the positive trajectory and we certainly hope to end the year with a reasonable growth in the profit as compared to the last year.

The other highlight of this quarter is that during the quarter we have seen a double digit growth in the percentage of car radials and in the agri radials. No doubt, the sale of the commercial tyres were a bit subdued because the economic activity is not moving at the pace which we have all wanted to be and also the pressure of the Chinese imports and which I will just deal with that like how we are dealing with it. Second highlight was that during the quarter we have seen a launch of the two and three-wheeler tyres by JK Tyres, which has been very well received in the market and I think in the coming period in the balance of the six months, the way we see it, I think the growth in the passenger and agri tyres shall continue. We shall see with a little better growth in the commercial tyres and the bottom line and the top line will also be aided by much larger volumes are expected in the next six months from the two and three-wheeler segments and also the TBR segment. Last but not the least, the radialisation is again moving at the pace that we have had all estimated. At the industry level, radialisation in the commercial segment is almost close to about 46%, and in the OEMs, the radialisation is almost as much as about 65%-70%. That gives a point that in the period to come in the radialisation the replacement will also increase. I think as I had mentioned last time, the company is going through a major change in terms of the composition. Still about two-three years back, our sales composition was two-thirds nylon tyres and one-third radial tyres. Now, I think this year we expect the sales to be two-third radial tyres and one-third nylon tyres. So, the profitability improvement that has taken place, no doubt a part of it has been contributed by the reduction in the raw material prices, but a significant part of it is because of the change in the product mix from nylon to radial tyres. I think this is a very key change that is taking place. Second, as I had mentioned earlier the import of Chinese tyres has certainly made some dent into the market, because they sell the products much cheaper than the normal Indian prices. Now, how we are dealing with it that we have now launched a new TBR product in the market called CDH and the other is CUC. How we are positioning it is for the same market segment where the Chinese are being sold. Let me tell you a little bit on the damage, the market is like this. In every market there are three segments, A, B, and C. A segment is long distance, being operated by very large fleet owners where the top brands like ours, where every fleet owner goes by the top brand. Then, there is a medium business market which is the B segment of the market which is again serviced by the good brands like we have different products for that. So, then there is a C segment of the market which is mostly into the shorter distance and to the construction material, into the perishables and all that who are very value conscious, may not be that brand conscious. So, the Chinese have been so far serving in this segment, so what we are doing is we are spreading to this segment of the market also by bringing in equal products and with the equal pricing and with the equal sales efforts because all of our tyres carry a lifetime warranty against any manufacturing defect. Now that when the Chinese come here, they do not offer any warranty, so for this C segment of the market, we are offering no warranties and at the B segment of the market there are limited warranties available and in the A segment of the market there is a total 100% warranty available. I think this is how we are meeting the Chinese competition. Now, keeping this in view and also that the Government's spend on the infrastructure in the number of road projects, the number of highway projects that had been announced and which have started already, I think keeping this in view, we feel that the next six months should be significantly better than the first six months of the current financial year. So, this is what all I had to say. The only other thing that I can add is that the acquisition of Cavendish which we had completed in April 2016. As mentioned last time also that the production started by end of April and the dispatches from Cavendish factory started by mid to end May. Now, that is also progressing very well. Currently, the two and three-wheeler capacity utilization has almost reached to about 50-55% and in the TBR we are almost operating at about 40-50%, and in the nylon products again we are operating at about 35%-40%. I think by the end of the year that means in the last quarter of the year, we are aiming to reach the optimum capacity utilizations, that means we should be making full utilization of the two and three-wheelers and a fairly high utilization in the TBR and the nylon product segment. Fortunately, even in the Q2, the

Cavendish has added to the top line and bottom line of the company. Last but not the least, earlier the two and three-wheeler tyres that we had launched was in the economy category. Now, we have launched premium two and three-wheeler tyres under the brand Blaze and that has also been very well received. I think the coming six months should see a significant increase in the sales of the Blaze products also. So, this is what all I had to say and I will be happy to now address any questions.

Moderator: Thank you very much. We will now begin with the question and answer session. Anyone who wishes to ask a question may press "*" and "1" on their touchtone telephone. If you wish to remove yourself from the question queue you may press "*" and "2". Participants are requested to use handsets while asking a question. Ladies and gentlemen, we will wait for a moment while the question queue assembles. We take our first question from the line of Ashutosh Tiwari from Equirus Securities, please go ahead.

Ashutosh Tiwari: Congrats on the good set of numbers, if I look at the consolidated other operating income, it has risen very sharply over the last two quarters, so what is the reason behind that, because of that the subsidiaries operative is very high.

A.K. Kinra: You see the other income from the other operating income is not a very big number, nothing very extraordinary and this is only the normal other operating business of the company.

Ashutosh Tiwari: Sir, if we look at Q2 last year it was around 19 Crores, now it is around 113 Crores, there is a big jump happened over there.

A.K. Kinra: 113 Crores is in the quarter because when we took over Cavendish, at that point of time we had foreseen all this that in for the first six months a lot of promotional expenses will be required and the provisions were made pre-acquisition itself. So, during the quarter, now as the expenses are being made on the expense side and since the provisions are already made on the other side, so this operating income comprises a reversal of those provisions, but again I would say on the other operating there will be provisions as well, but on the expense side those expenses are included. So, overall it has not much impact on it.

Ashutosh Tiwari: Okay, so if I look subsidiary EBITDA margin it is 34%, is it that high level of margin we already have in subsidiaries?

A.K. Kinra: Subsidiary EBITDA again, as I mentioned to you that EBITDA of 34%, some part of this explanation is attributable to the expenses undershooting the line on the income that is there on the other operating income. So, some part of that is explained by that only.

Ashutosh Tiwari: Okay, how long it is going to be reversed, I mean is it completely reversed now or it will continue for more quarters?

A.K. Kinra: For the future also I think to my mind whatever we had foreseen at the time of acquisition, I think now it is already on a full stream so we do not foresee in the future quarter that there shall be any subsequent reversals.

Ashutosh Tiwari: Okay. Secondly our total debt is 5200 Crores at the balance sheet of September 2016?

Sanjiv Saxena: The total debt no doubt is about 5200 Crores comprising of JK Tyres, which I think have mentioned earlier and JK Tyres is 3000 Crores and the other subsidiaries CIL and Tornel is 2000 Crores, so that is the total debt. Again this includes the debt that has been organized in the books of Cavendish directly at the time of acquisition, so that is why on a consolidated basis the debt has now come in to the total consolidated balance sheet, but I think if you ask me we have now almost peaked out in terms of debt because in the case of JK Tyres the Chennai expansion has been completed in March 2016 so whatever debt was required we have already drawn the entire debt and in terms of Cavendish the debt that we took over from the banks and funded in the acquisition that entire debt has also now come, so 5200 was the total debt and we seemed to have now peaked out. I think by the end of the year in the case of JK Tyres some repayments have also started and I think at the end of the year we should see the debt almost at the same level or maybe a little lesser than this level only.

Ashutosh Tiwari: My question is that if I look at the interest cost on quarterly basis it was 110 Crores only, some part of that debt is getting capitalized as of now or we are not paying interest on that, your interest cost seems to be quite low?

Sanjiv Saxena: The total interest is 111 Crores, as I mentioned you earlier that the debt has peaked out and I think the interest cost also should be retained at this level at least in the 2016-17 and I think we should be the year as a whole we should see the interest at about 400 Crores.

Sanjiv Saxena: And also I may add that if you see the annualized impact of this interest, which is nearly 200 Crores for the sixth months, also too close to 400 Crores for the entire year that will be close to 8% of the total debt.

Ashutosh Tiwari: Is that the cost of debt basically for us?

Sanjiv Saxena: It is because of the excellent debt management in the company as well as we have some foreign exchange borrowings which we have taken from the point of view of reduction in the cost of borrowings.

A.K. Kinra: I just to add to what Sanjiv has said, two more reasons. The debt that we had taken for the expansion for the setting up of the Chennai facility and expanding the Chennai facility, now the repayments have also started and the company has absolutely suffices in a most exemplary manner, so on the one hand debt repayments have started and on the other hand there is not any debt inflow to JK Tyres and whatever inflow has taken place has already been peaked out in March 2016 and in the case of Cavendish also I just need to repeat that whatever debt had to be taken at the time of acquisition that entire debt has been drawn, so as mentioned on the whole we should see the year with the overall interest obligation of about 400 Crores, which on a debt of 5200 Crores that means average cost is only about 8%.

Ashutosh Tiwari: Sir, lastly in terms of utilization level of our capacities, how much is that segment wise TBR, TBB, and passenger cars?

A.K. Kinra: Let me tell you that in the case of capacity utilization as I mentioned earlier, currently in the case of JK Tyres we are utilizing TBR almost at the full extent, PCR generally normal utilization at the rate of about 85% because of this year volumes involved, and TBB we are utilizing to the extent of about 65-70%, so this is in the case of JK Tyres and in the case of Cavendish I think I have already mentioned that to you I do not have to repeat.

Ashutosh Tiwari: But Sir in case of TBR also in JK Tyres we have expanded Chennai, last year also it got completed so obviously on the expanded basis utilization level should be lesser right?

A.K. Kinra: I think I mentioned to you like in the case of expansion also the utilization is now almost full, even the month of September I am so happy to say that our utilization was slightly more than 100% even of the expanded capacity and of also the expansion on a standalone basis.

Ashutosh Tiwari: So in that case will be looking for expanding further in TBR?

A.K. Kinra: We have just acquired Cavendish which has a capacity of the TBR almost as much as above 1 lakh tyres per month and 12 lakh tyres per annum, so I think what we will do is we will first absorb this capacity of 1.2 million tyres of TBR and then think of an expansion. I feel that in the next at least two to three years we do not foresee any major capacity expansion taking place because keep in mind that with the Cavendish acquisition our domestic capacity has gone up by as much as above between 50-60% totally. I think we will absorb this, we will consolidate, we will sweat the assets for the next two to three years. Other than two and three-wheelers because our total acquisition capacity is 63 lakh tyres. As I mentioned you before the year closes we hope that we will be utilizing it fully and keeping in view that the growth in demand is almost at about 10-12%. We may require some additional capacity, but that number is very small hardly 200 to 300 Crores of Rupees in the next year is only about two and three-wheelers, but by and large the company does not expect at least in the next two to three years any major capacity expansion taking place.

Ashutosh Tiwari: Okay Sir, and you also mentioned that in the last quarter there was double-digit growth in PCR and farm tyres. How was our truck tyres, how much declining we saw basically in the standalone JK Tyres?

A.K. Kinra: I think I have mentioned to you that truck volume had no decline and that is not the right statement to make. The shift that is taking place is from nylon tyres to the radial tyres, so I think on an overall basis this almost remains the same. There is absolutely no decline in the markets. Initially that the PCR agri have recorded doubt digits and in the case of truck it is almost flat. I think in the coming six months' time we see even the truck tyre demand going up reasonably well because you have seen the numbers of the Ashok Leyland and Tata Motors they are all increasing their capacities and their production volumes are also going up, so we hope that the truck tyre demand should go up also reasonably well in the six months' time.

Ashutosh Tiwari: Okay Sir, thanks a lot.

Moderator: Thank you. We take our next question from the line of Rohan Korde from Prabhudas Lilladher. Please go ahead.

Rohan Korde: Thank you, Sir you partially answered my question that I wanted to ask on Capex, so basically you will look at maintenance Capex spend for the next two years, is that correct?

Sanjiv Saxena: It is only the maintenance Capex, it is in the region of mainly 80 to 100 Crores per year and there is a hiding factor and we always maintain that expenditure, it is a normal expenditure which we maintain.

Rohan Korde: And at Cavendish do we need to infuse any fund for working capital to make it more efficient?

Sanjiv Saxena: No we have already made sufficient arrangement for Cavendish working capital.

A.K. Kinra: I will just add to what Sanjiv just said. When we took over this company we did not have any working capital before the whole transaction was without any working capital. As soon as we took over we started building the stocks, so there is now enough working capital built in for the inventories, some has been built in for the receivables. The company has also provided for the required margins on the working capital and also tied-up adequate working capital facilities with the banks, so far we are concerned we are absolutely now fully funded in terms of working capital also.

Rohan Korde: Would you be envisaging any increase in rubber price pursuant to demand increase?

A.K. Kinra: The rubber price increase which has taken place in the last two months after a severe dip, it had fallen to as low as well 91, it is in the 120s now. We feel that the price of 120 is a sustainable price. We do not foresee any major swing taking place in the price in the next six months' time. I cannot make any estimation of the price expectation, but we feel that this is sustainable.

Rohan Korde: Okay Sir this was very helpful, thanks a lot.

Moderator: Thank you. We take our next question from the line of Deep Shah from SBI Cap Securities. Please go ahead.

Deep Shah: To begin with what you mentioned**,** just wanted to understand what gave you the confidence, can you just elaborate what sort of expectations you have from this business?

A.K. Kinra: As far as the two and three-wheelers are concerned I can tell you that currently the demand is growing by about 10% to 12% at least in the next two to three years' time that is the projection that we can make. We feel that any demand should go up by again in the range of 10%, 15% that is one. Second with regard to any OEM tie-ups unfortunately when we took over this Cavendish we erstwhile had already discontinued the supplies to the OEMs, they were all suppliers to Bajaj Auto or Hero, we discontinued a couple of months before we took over. Now to get the preapprovals it is a long-drawn process because they inspect the plant once again and the process has already started. I think if everything goes on well in the current quarter we should see some of the earlier OEMs back to our fold and start buying from Cavendish.

Deep Shah: That is helpful Sir. Second is on the C segment tyres, you have mentioned you have launched tyres comparative with Chinese products, so just wanted to understand is actually the buyers of your tyres and how your tyres are good or at least better than the Chinese tyres and how is the pricing there, what is the price gaps, is it still be 20% to 25% at industry level, if you can throw some lights over there?

A.K. Kinra: Let me tell you your two parts of the question. Number one is who is the buyer, you see in all these cases I think I mentioned you earlier there are separate market segments. As I said the top segments is the large fleet owners, the medium segment is this fairly medium-sized fleet owners, and the C segment as I said where the end use application is shorter distance, perishable, the construction material. So there is certain separate category of buyers for that only, so that is the market segment which is there separately now that is one. Second, you asked me the question regarding price gap between the A segment and the C segment. The price gap can be somewhere between 10% to 15% but again I think that is not the way we should be looking at, not only the price gap, we should also see from a total gap of the costing also and ultimately these are very different tyres so if the price gap is 15% there is the reduced cost also, this is how it works. Secondly, you asked me the question with regard to the comparison to the Chinese and I think I mentioned to you earlier also that in this segment we are giving the same tyres which Chinese are giving at the same quality, same price, and same sales conditions. So it is almost at par with the tyres because we certainly have valuable advantage for the local conditions of their tyres. This quality is slightly better than the Chinese. And secondly very major issue is with regard to the certification. All Indian tyres have to go through the certifications by the local bureau of Indian Standards, whereas the Chinese they come into the market and there is no certification, so that way I can say that we certainly stand in a better position compared to the competition from China.

Deep Shah: And Sir just to continue with the same question on Chinese tyres, our channel checks suggest that Northern India is accounting for large chunk of Chinese tyre consumptions that is the markets like Delhi and neighboring markets of Delhi and the penetration of Chinese tyres is comparatively lesser in other parts of India.

A.K. Kinra: There has been no doubt and what you are saying is right that the competition is little bigger in the Northern markets only, but then again I think my answer would remain the same what I said earlier also. Since we are also well located in the North part of the country, I think you have to compare ultimately everything the landed cost of the tyres with the dealer. If he brings from the port there is an extra cost that we see when we compare, you obviously compare the landed cost to the dealer.

Deep Shah: If GST has to kick in then what impact will it have on Chinese tyres because their price would go up, is that the case?

Sanjiv Saxena: In case of GST there are certain credits which will now become available to the trader in our view, so it will be an organized tyre buying and there is a likelihood that the Chinese tyre imports may remain the same or the chances of tapering down may not be very much significant. Therefore, there is an urgent need for the government to impose the antidumping duty to protect the Indian tyre industry.

A.K. Kinra: Again to support what Sanjiv was saying whether Chinese tyres have a GST impact or not it does not have impact. Ultimately when we price our tyres for the same category it is the landed cost of the tyres with the dealer. If since the Chinese tyres are going to be say 100 now, later it is 102 or it is 98, so I think always the domestic players will also be matching the same market at the same price only that is how it works.

Sanjiv Saxena: Also to add to what Mr. Kinra said that in case of the domestic manufacturers also, there is a rubber sale for example which was not convertible earlier, so rubber sales will be an advantage for the Indian tyre sector, so honestly players also tend to gain enormously due to the implementation of GST, so it is a win-win game as a matter of fact.

Deep Shah: Thanks a lot Sir.

Moderator: Thank you. We take the follow-up question from the line of Ashutosh Tiwari from Equirus Securities. Please go ahead.

Ashutosh Tiwari: Sir just tyres that we launched in the C segment is it from Cavendish or it is from JK Tyres?

Sanjiv Saxena: It is mainly from Cavendish.

Ashutosh Tiwari: And secondly any pricing increase or cut we have taken over last two months in any segment?

A.K. Kinra: When we say C segment, these are manufactured at both the places. It will be manufactured in the JK Tyre locations also and will be manufactured at CIL location. Having said the same, it will also be other way around that even the A segment also it will be manufactured at both the manufacturing locations at JK Tyre locations as well as the Cavendish. It is not that we will be manufacturing only the C segment tyres at the Cavendish only, we just cannot do it that way, because ultimately Cavendish is also one of the first class manufacturing location there, they are also cable of producing the top grade quality in any of the tyres. Again, it is not that as if they will do only the C segment and they will be selling at 15% less that is not how it works. As I mentioned earlier if the price of the tyres in the C segment is 85 compared to 100 in the A segment. The cost is also less proportionately. This is how you have to see that will be reserve, we watch out always the tolling margins as we call it that means the unit sales minus the raw material cost is the margin. We are always working on that only, because no tyre manufacturer can afford it that way and that is our strategy.

Ashutosh Tiwari: Secondly any pricing increase or cut which has happened over last two months?

Sanjiv Saxena: Not significantly. The price cut was only in order to respond to the competitive intensity, whatever marginal or very nominal price decrease or increase if it were to take place in the last two months we have done. Again, of course in the last two months there is a very marginal dip in the price.

Ashutosh Tiwari: And this is both in bias and radial truck tyres or only one of them?

Sanjiv Saxena: I think we are slightly in a better position with respect to the radial tyres because we were the ones to pioneer the concept of radialisation in the country way back in 1995 or somewhere around that and it is because of that reason that we are here for more than 20 years for this radialisation and we command better price positioning there.

Ashutosh Tiwari: And lastly Sir, currently how much total tax we pay to the customer compared to GST rate, all put together how much tax is there?

Sanjiv Saxena: I will tell you, what happens is that the central excise duty is 12.5% and the VAT is 14.5% in quite a lot of states and 12.5% in some other states, so put together you can see somewhere around 25% to 26% as the total amount of tax impact. Now when you compare it with the GST rate, there is a likelihood that the GST rate is going to be 18%, at the same time there is average school of thought which talks about the vehicle which was likely to attract 28% of the tax rate, so people are worried that probably the rate of the tyre is also likely to be 28% which should not be the case because tyre is an item of public utility and tyre is used for transportation of almost everything right from sand going up to the gold, silver, platinum, palladium anything and everything, for all these needs tyre is required even for medicines, even for toiletries, small things and big thing, so tyre is a public utility item and we expect that the rate should be around 18%.

Ashutosh Tiwari: So a reduction would happen over there right?

Sanjiv Saxena: This reduction should help the tyre industry if we compare it with 25%, 26% versus 18% it should be helpful for the tyre industry.

Ashutosh Tiwari: You said earlier that there is some raw material which is not getting compensated, so what was that essentially?

Sanjiv Saxena: That was inverted duty structure actually. The customs duty impact is 20% or more whereas when you import a tyre the duty impact is 10% and even in case of certain countries where free trade agreements are there the impact is as low as 6% to 8%.

Ashutosh Tiwari: But that would not change with the GST?

Sanjiv Saxena: Inverted duty structure we cannot comment on that because what happens is that the customs duty is 20% today and customs duty is not going to touched by GST rates at all. However, the good news is that when the imports takes place which are not under the advance licenses then the impact of the counter billing duty which is available for set off, actually the higher amount which will be available.

Ashutosh Tiwari: Okay that is not different to you basically.

Sanjiv Saxena: Yes.

Moderator: Thank you very much. As there are no further questions from the participants, I would now like to hand the conference over to Mr. Mahantesh Sabarad for closing comments.

Mahantesh Sabarad: Thank you very much Sir for patiently answering the questions and we are happy to host this call. Thank you all the participants.

Moderator: Thank you very much. On behalf of SBI Cap Securities Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.