"CEAT Limited Q2 FY18 Earnings Conference Call"

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MODERATOR: **MR. TUSHAR CHANDRA – ICICI SECURITIES**

Moderator: Ladies and Gentlemen, Good Day. And Welcome to the CEAT Limited Q2 FY18 Earnings Conference Call, hosted by ICICI Securities Limited. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. In case you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Tushar Chandra from ICICI Securities. Thank you and over to you, sir.

Tushar Chandra: Thank you very much. Good evening, Ladies and Gentlemen. ICICI Securities is extremely proud to host the CEAT Q2 FY2018 Earnings Call. Today on the call we have Mr. Anant Goenka – Managing Director, as well as Mr. Kumar Subbiah, he is the CFO. And also, Pulkit Bhandari who manages the Group IR.

We will start off with a quick review of the quarter and some opening remarks by Mr. Goenka, and followed by Q&A. Back to the operator. Thanks.

Moderator: Yes, Mr. Goenka, you may please go ahead.

Anant Goenka: Thanks, Tushar. Good evening and a very warm welcome to CEAT Q2 FY18 Earnings Call. I am Anant Goenka, Managing Director; and I have our CFO, Kumar Subbiah here with me. I will take you through our performance for quarter ended 30th September 2017.

On a year-on-year basis our net revenue from operations has grown by 7% and stood at Rs. 1,512 crores for the quarter. The first two months of the quarter were affected by GST and the channel adjustment towards the new taxation system, however, things have begun to stabilize and improve from the month of September onwards. Our raw material prices came down during quarter two versus quarter one as the margins bounced back versus quarter one levels. Notwithstanding the recent price increases in crude that we have seen, we overall expect raw material prices to remain stable for the remaining part of the year.

With respect to BU wise sales, broadly we have seen mixed results in OEMs as well as with respect to our replacement and export segment. I would say, largely the OEM segment has grown pretty well with high growth rates in passenger segment, LCV segments and we expect demand to be robust for the rest of the year. Exports on the other hand had been having some challenges, particularly with respect to a bunch of external factors relating to rupee appreciation, foreign currency unavailability in key African markets like Egypt, political unrest in certain countries like Kenya, trade quotas in Indonesia, all of this has had some impact on exports.

Last year's numbers largely being affected in quarter three by demonetization, we expect going forward growth rates are to be better, largely because of a low base effect.

I will share a few highlights for the quarter gone by. I am happy to share that CEAT won the prestigious Deming Prize, which is an award that recognizes companies to achieve business transformation by total quality management. The Deming Prize was founded in Japan and is one of the oldest and most prestigious quality awards in the world, and CEAT is the first tyre company in the world outside of Japan to have the honor of receiving it.

We also received recognition by the International Advertisers' Association for creative excellence in our TV campaign which we have titled as Mr. Hath Dikhau. On the product side, we launched an exciting new product called Mileage X3 for passenger car tyres, it has a unique value proposition of more than a mileage of 1 lakh kilometers and it is met with positive response across cities and we look forward to consolidating our position in the passenger car side through this new product launch.

We also entered Mahindra's first electric three-wheeler, the E-Alpha which was launched on CEAT tyres. With our larger purpose of making roads and mobility safer, along with MMRDA, we undertook an eco-friendly initiative which we call CEAT Happy Roads to repair potholes in Mumbai by recycling old and worn out tyres. We adopted a unique digital approach to launch this initiative with a short video which went viral on YouTube with more than 1.4 million views.

Overall, we expect the challenges of the last eight months to have reduced with demonetization and GST in a way coming to an end and stabilizing. And we expect, going forward, growth to be more positive.

With these updates for the quarter, I will now hand over the call to our CFO, Mr. Kumar Subbiah.

Kumar Subbiah: Thank you, Anant. Good evening, all. I will present before you the key financials for the quarter. In the quarter our consolidated revenue stood at Rs. 1,523 crores, which compares well versus Rs. 1,460 crores in quarter one of this year and Rs. 1,427 crores in quarter two of last year. This growth translates to about 4.3% over the previous quarter and 6.7% year-on-year. Our consolidated margin for the quarter stood at 39.4%, it has expanded by about 520 bps sequentially and contracted by about 320 bps over the same period last year. The expansion of gross margin happened largely due to lower raw material cost during the quarter.

We exercised good control over discretionary operating expenses, leading to drop in other expenses by 8.6% quarter-on-quarter and 2.6% year-on-year. You would recall, we had done a similar control of opex expenses in the previous quarter and we expect the benefit of this reduction and opex cost to flow through in the full year results too.

Our consolidated EBITDA for the quarter stood at Rs. 181 crores, versus Rs. 58 crores in the previous quarter and Rs. 194 crores in quarter two of last year. The consolidated EBITDA margin for the quarter was 11.9% and the standalone EBITDA for CEAT is about 12%. The effective tax rate for the quarter has increased, largely on account of lower income tax benefits on R&D spend and withdrawal of investment allowance effective this financial year.

Company's consolidated net worth as of 30th September, 2017, was Rs. 2,462 crores and consolidated debt was about Rs. 1,016 crores. The long-term borrowings declined on account of prepayment of higher cost long-term loan to the tune of about Rs. 100 crores and regrouping of current maturities of long-term debt under short-term. Our debt-equity ratio continues to remain healthy at 0.4 times.

With this, we will now open the Q&A. Thank you.

Moderator: Thank you very much. Ladies and Gentlemen, we will now begin the question-and-answer session. We have the first question from the line of Nishith Dalal from Kotak Securities. Please go ahead.

Nishith Dalal: I have two questions. Firstly, how was your volume growth in this quarter? And specially, you mentioned that replacement started picking up from September onwards, so I am assuming that restocking has not happened to the fullest completely in this quarter. So, do you see that continuing in the next quarter as well and then basically the volume growth should improve?

And my second question is, if you can talk about your CAPEX plans, especially the Ambernath plant, as to where are we in the testing cycle and when should we start seeing commercial production happening in a meaningful manner? Thank you.

Anant Goenka: Thanks, Nishith. So, for the quarter volume growth was slightly lower than our growth of about 6%, somewhere between about 1% to 2% kind of growth in volume terms that we saw. We expected, July and August particularly, we continued to see similar kind of levels that we saw in the latter half of quarter one, so I will say the GST impact certainly was felt at that point of time whereas September being end of Monsoon time usually a month where we sell better began to pickup. I would say one challenge that we faced, particularly in our case, we have a large number of two-wheeler who are small channel partners and they were adjusting, they took more time to adjust to the new system. And therefore we found a number of the sub-dealers who were billing pre-GST had stopped billing for some time. As we have gotten used to the system we have come back to normal kind of billing numbers or if we look at the channel numbers we are back to those kind of numbers in terms of number of people who are raising bills. So, that has been one positive development. And I would one other impact that will come going forward is that post November 8th of last year sales have me-too cut it to that extent that base effect would have come down. So I think the growth impact that we will see going forward may be slightly better than what we were seeing earlier.

On our CAPEX plans, the Ambernath plant has started to get operational. We have been testing the products over the last four months and we have seen some positive response on that. Right now the tonnage utilization of this plant is extremely low because it has just been set up and we have just recently got our consent to operate, and therefore we are now beginning to ramp-up. We expect to reach about 50% to 60% capacity utilization levels in about say four to five months' time from now. And we will soon be taking a call for that further expansion, we have anyways planned the plant to be about 100 tons per day, today we have set up enough capacity for 40 tons per day. We will soon be picking a call to take it up to 100 tons per day just because we are very confident that the products are now doing well, and that was more of the criteria for taking the call because we had not produced these tyres in the past or tested the quality of these tyres in the past. So, the confidence level has been quite positive. Rest of the CAPEX plans are largely on track. Our two-wheeler capacity in Nagpur is undergoing expansion as we speak. Our Halol plant which was having a passenger car expansion, that is also under way. And we are now looking at setting up passenger car facility near Chennai where we have also acquired some land and we will be looking at setting up facility there as per our plan of spending around Rs. 2,800 crores in total across all these categories going forward.

Nishith Dalal: Okay. So, just a follow-up, so the guidance of Rs. 500 crores to Rs. 600 crores CAPEX for this year and next year, that still holds?

Anant Goenka: Yes.

Moderator: Thank you. We have the next question from the line of Amin Pirani from Deutsche Bank. Please go ahead.

Amin Pirani: My first question is on the volume growth of 1% to 2% which you mentioned, is it also low because, I mean is it the tonnage number and that is low because your share of two-wheelers has increased whereas CVs has remained flat? Or is it like that every category also the volume growth would be in the similar range?

Anant Goenka: So, what happened is that in even the two-wheeler segment we were growing quite well until last year. Whilst scooter continues to be very strong, motor cycle particularly has got hit a little bit, I mean it has still grown but it has grown at a lower pace than what we were seeing earlier. On the other hand, for example, the truck bias segment has been showing negative growth. So, in past, because of the overall slowdown that we have seen in the last four or five months, that in a way has continued with two-wheeler getting a little bit of a larger hit in terms of delta. And exports has had a little bit of further adverse effect just because of overall these external factors that I shared on the call. So, these are the two or three aspects that have caused negative impact. I think exports are expected to pick up in quarter three, and I would say that again I think growth in quarter three will be much better because of the demonetization, GST and all of that now behind us.

Amin Pirani: And any indication you can give on what kind of price hikes you have taken, say from the beginning of the year in truck bias or in two-wheelers?

Anant Goenka: Yes, approximately we have taken a price increase of 3% to 4% in the month of May where raw material prices really shot up by about 30%. So, if I recollect right, it is about somewhere between 3% and 5% across different categories. Orrisa was one where we took less price increase but more on the commercial vehicle side and passenger car side relatively this 4% to 5% price increase that we took in the month of May. Besides that there has been no major change in pricing.

Amin Pirani: And just lastly, if I look at the quarter and across companies, in a way it has worked like clockwork because margins were expected to come back and they have, thankfully for everybody. And growth also seems to be coming back in varying degrees. So, as you look forward for the next six to nine months, are there any risks according to you which are still out there unresolved or are we now in a more steady state compared to last one year?

Anant Goenka: I think we are in a more steady state, one is from a raw material front. I think at least for quarter three we would have largely brought all the raw material and we know what is expected and we expect it to be largely stable. Quarter four we are already in the month of November, if I look at three months going forward I think most people would be covering and whatever is coming in will be coming in all the way until February already. So, for the rest of the year we have secured the raw material side. I would say the risk that is there, the competitive pressures are there, there is a price impact that comes in because of prices drops or some of those things, that is something that is unpredictable. But I would say, besides that, largely from a growth perspective across categories I think we are relatively okay.

Moderator: Thank you. We have the next question from the line of Niket Shah from Motilal Oswal. Please go ahead.

Niket Shah: Three questions, first, if you can just share in the passenger car segment I think the market share has remained in higher single-digits and we have been working extremely hard to repeat the success of two-wheeler in the passenger car segment. So, any success there or any signs that you are seeing where you think that you will start gaining market share as you move forward? That is question number one. And second is on the off-highway tyre segment, if you can just share from a demand perspective, you started with 40 metric ton capacity, heading up to 100 metric ton. Are you confident enough to sell 40 or you are confident enough to sell the entire 100 in FY19 or 20 as we move forward? so those are the basic two questions.

Anant Goenka: Okay. So, on the passenger car side I think things are coming along extremely well. We are growing well and we will continue to grow well and I have very high level of confidence of high growth on the passenger car side. Now whether we will be able to see the kind of market share growth that we have seen in passenger car is a question, but I would say that certainly we are very optimistic, we are seeing very good traction and satisfaction from the customer's side on our product excitement from demand perspective. On the supply side we need to make sure we need to ramp-up very quickly and we are able to supply, otherwise I am very confident on the passenger car side growth.

Niket Shah: Anant, any sense that you can give in terms of any clientele that you have got penetrated or you are in advance stages, any sense which can give us more comfort regarding a very strong growth going forward as far as this category is concerned?

Anant Goenka: Yes, so for example, our OEM relationships have strengthened far more. I would say, earlier we had limited capacities with our OEMs and therefore we could not engage well enough or strongly enough with the OEMs. With Halol plant coming in and the expansion happening, we have strengthened our engagement with them. The number of first projects that we are working on is higher than ever. Every quarter we get record number of request for quotations from our OEMs and our share of business with them has increased just the way we have seen it happening with the two-wheeler side with the number of leading OEMs that are there. So, that is one. Because these are the large customers who we can talk about, the others are largely retail customers, who are not specific anecdotal customers. But on the retail side our Fuel Smarrt launch that we had done about three, four months ago, and now the mileage launch is creating a very positive buzz. Whole things is we are moving towards higher inch sizes which are higher margin products. So, on the passenger side I have a high level of confidence on success from our product as well as on demand side. On the off-highway tyre side, we have set up a 40 tons per day capacity, as I said we just got our consent to operate in October. So, in terms of versus 40 tons per day we have been producing only 3 tons to 4 tons to 5 tons per day at that kind of range and we will be ramping up, as I said. I have again a very high level of confidence of reaching 100 tons per day capacity. I say, next year it is going to be about ramping up to the 40 tons per day, it will take another year to set up the balance 60 tons per day capacity at least, at least a year. So, by the time that 40 to 60 ramp-up comes in, we are talking about 2019-2020 is when we will be reaching that 100 ton per day capacity. So, that is sometime away, the 40 tons per day capacity will happen over the course of next year for sure.

Niket Shah: Off-highway tyre capacity, the major fixed cost is obviously there, but is it a business where as you significantly ramp-up your utilization rate your operating leverage is going to be massive? And is this is a category where some of the names like Balkrishna make more than 33% to 34% kind of margins in the best of their times, should we assume more than 20% margin at least in this category to start with and then moving closer to 25% - 30%?

Anant Goenka: Yes, absolutely.

Niket Shah: Got it. And the final question is on the inventory at the distributor and obviously September would have been a good month, but is the inventory back at normal levels or do you think there is room for it to come back to normal levels going forward?

Anant Goenka: I think inventory largely that is something which I would like to answer a little bit later, just because I do not have the data. But overall, I would say that the restocking has started to happen from September. Now, whether there will be more restocking happening, I do not have the data to answer that question.

Niket Shah: Sure. And what was the impact of GST on your revenue, because obviously the numbers are not comparable from a sales perspective. So, if we have to get a comparable number as last quarter versus this quarter, I mean how much number should we add to sales number to get a comparable number?

Kumar Subbiah: See, last quarter you have to take the revenue as Rs. 1,459 crores on consolidated basis and this quarter we have to take Rs. 1,523 crores, it is about say Rs. 64 crores more.

Niket Shah: So, this quarter we will have to add Rs. 64 crores to get correct picture of sales growth?

Kumar Subbiah: Yes, that is true. Also, one small thing, Rs. 1,459 crores also includes some other income of about Rs. 23 crores. So, you add that also.

Niket Shah: No, so other operating income or other income?

Kumar Subbiah: Yes, other operating income which is not directly relating to sales, so 1459 minus 23, 1436 versus 1523.

Niket Shah: So, you are actually reducing Q2 FY17 number to get GST comparable number, right?

Kumar Subbiah: See, the difference between last quarter and this quarter is, last quarter revenue had excise duty included in it.

Niket Shah: Last quarter is first quarter you are saying or last year same quarter?

Kumar Subbiah: No, I am talking about quarter one financial year 2017-2018.

Niket Shah: No, I am comparing Q2 FY17 with Q2 FY18.

Kumar Subbiah: Okay. So, then if you compare that, Q2 FY16-FY17 was 1427 and this time it is 1523.

Moderator: Thank you. We have the next question from the line of Kaushal Maru from DSP Blackrock. Please go ahead.

Kausal Maru: Could you give us a broad indication of how the replacement market has grown in the various segments, two-wheelers, passenger cars and CVs?

Anant Goenka: We usually do not provide that specific data, but overall I would say that commercial vehicles had grown slightly slower than our passenger vehicles, which includes the two-wheeler and passenger car segment. I can give you that kind of broad estimation rather than a category wise breakup.

Kausal Maru: So, low single-digit, mid single-digit or a high single-digit growth, even that number if you can give?

Anant Goenka: So, I think we would like to leave it at that.

Kausal Maru: Okay. Sir, in the raw material prices, do you think in Q3 there are further benefits which we are yet to accrue and that should mean margins being higher from where we are?

Anant Goenka: No, I think raw material prices are expected to be largely stable Q2 to Q3, no major change. May be marginally 1% here and there but nothing much.

Moderator: Thank you. We have the next question from the line of Jai Kale from Elara Capital. Please go ahead.

Jai Kale: Sir, my first question was regarding the volume growth and revenue growth, if I see your segmental revenue growth, approximately your two-wheelers would have grown in double-digits in terms of net sales based on your presentation. And largely GST related issues would be pertaining mainly to the two-wheeler segment since they are more smaller dealers in the two-wheeler segment. So, how should we look at the core growth, is it fair to assume that had this GST transition not been an issue you could have seen may be more stronger growth than what you have seen in double-digits for two-wheelers? Or is it that the sub-dealers are the ones who are taking more time for the GST related transition and your billing is mainly to the distributors and hence maybe it is more of a transitionary inventory side gains?

Anant Goenka: No, I think it is a fundamental issue at the sub-dealer level who are not picking up material because of the GST challenges with respect to either not wanting to pay taxes or registration into GST, etc. And so it was more of an issue of not of inventory but actually fundamental demand. So, I think if hypothetically GST were not to come into effect then no impact out there, I would say that we should have grown better on the two-wheeler side.

Jai Kale: So, you are saying that the industry has come back strongly on the retail side, at least?

Anant Goenka: Yes. Has come back better than what we saw from May to July.

Jai Kale: Okay. Sir, my second question was on the other expenses, there is extremely strong cost control on that side. But how sustainable it is, is it that some of the discretionary expenses which was curtailed in 1Q because of low volumes also, 2Q was kind of suffering because of low volumes of transition. So, do you expect that to may be come back sharply in Q3 or Q4 or this is just sustainable cost reduction measures that you all have taken?

Anant Goenka: No, I think largely we can sustain this kind of broad levels of expenses. Kumar, would you like to elaborate anything on this?

Kumar Subbiah: Yes. A couple of things, we exercised strict control over discretionary cost in quarter one and quarter two and the benefit of about Rs. 7 crores to Rs. 8 crores in the current quarter as well as the previous quarter we would be able to realize it in the full year numbers. So, it is not that we have deferred those expenses. Second is that we have also taken few steps to bring down our opex cost in the communication, travel, then some other discretionary expenses, etc, to creating an indirect procurement team which is focused on bringing down rates. So, it is sustainable in my view.

Jai Kale: Okay. And just one last, in terms of your volume growth we have seen that two-wheelers has done well but trucks has not been to that extent. So, how do you look at that market share over there, while we are focusing on the two-wheeler and four-wheeler segment, what would be the right level of market share to look at on the truck segment while that has not been an incremental focus?

Anant Goenka: Yes, so our truck approximate market share, say for example on the bias side has relatively been flattish at about 12% - 13% kind of levels, or somewhere around may be 14% levels on bias. Even though it has shown de-growth, the overall market has also shown negative growth. On the radial side our capacities are quite limited, so we hardly have any further up-room towards growing and our market share here would be somewhere around 4 to 5% kind of levels. So, this is where we are looking at now setting up capacity to take up our market share on the radial side. But since we have not focused much on it we have had limited capacity. Net, net, our market share here would be a little bit on the lower side.

Moderator: Thank you. We have the next question from the line of Chirag Shah from Edelweiss Capital. Please go ahead.

Chirag Shah: Two questions I have. On the truck side first, was trying to understand how the profitability in the truck business has been moving, because it has been a sore point in that sense in the overall scheme of things. So, can you just share how the profitability would be shaping in terms of warranty cost or various parameters?

Anant Goenka: Yes, so I think overall profitability on the truck side is getting better. We had some challenges overall in the past because of what we had estimated truck radials to be used for, we had thought truck radials would be used for the normal load segment, it eventually got used even in the overload segment. And therefore that resulted in slightly higher warranty cost for us about a year or two ago. We have since about a year ago launched an excellent product which has picked up and doing extremely well. As a result, our warranty costs have come down, claims have come down and we have been able to take our pricing up also and bridging our pricing with competition. So, I think truck is in a far healthier state. The most important thing is we have now an exciting very good truck product which will only get stronger and improve our profitability going forward. The challenge we will face over the course of the next few months will be supply constraint, which we need to therefore setup the new capacity very quickly and look at taking up those quantities as soon as this capacity sets up. Unfortunately, that is just about under a year away, so it will take some time.

Chirag Shah: So, can our profitability reach average profitability levels over next 12 to 18 months, can truck business be as profitable as our average profitability or that depends on the competitive intensity, how to look at that particular aspect?

Anant Goenka: No, I think as a category we find the passenger segment which includes car and two-wheeler is a bit more profitable than truck. So, if that is more profitable at all times and it will not reach average, it will possibly be just a little bit below the average because at a category level our strength lies more on the two-wheeler and passenger side, which therefore gives us more profit, may be because of price differential that we earn because of our strength in that category. So, until we are not able to take that price increase and increase our differential with competition, we will I would say still have a lower margin on the truck side versus our own other categories.

Chirag Shah: But scale is not necessarily a disadvantage to you versus competition on the truck side?

Anant Goenka: Not really, may be on a marginal side if you look at the manufacturing cost, certainly manufacturing cost comes down if you get better scale. So, I would say that certainly would be some impact, not a dramatic impact, may be a couple of 1% or 1.5% in my view on the truck radial side I am talking about.

Chirag Shah: And currently what would be a broad mix between radial and bias in terms of within the truck how the mix would be?

Anant Goenka: About 30% to 35% radial and balance bias.

Chirag Shah: And that portion cannot go up until we put up a new plant, right?

Anant Goenka: Yes.

Moderator: Thank you. We have the next question from the line of Nitesh Sharma from PhillipCapital. Please go ahead.

Nitesh Sharma: So, continuing on the GST transition related question, wanted to understand if the volumes impact were temporal in nature or do you think it would sustain for the next one year? Because what we understand is dealers have been stocking less inventory, so just to give you an example, someone who was stocking Rs. 1 crores worth of inventory now is stocking just Rs. 80 lakhs worth of inventory because of working capital issues. So, do you think that it is more of a temporal issue or it could last for next eight to nine months?

Anant Goenka: No, I think it is a temporary issue, I do not think it will go beyond quarter two, I think quarter three onwards things should get better as they stabilize. It could happen in few pockets where people have still not adjusted, but largely I do not see the uncertainty or destocking concern continuing because once the GST has come in it is about people getting used to this, they will take two, three months to find solutions on how to either pay tax or avoid paying tax. And they will come to that solution and then start doing whatever new way of doing business that they find in that two, three months. I do not think it can take too long for them to readjust to the new system. In the end they have to do business however it is.

Nitesh Sharma: And are we offering any sort of financial assistance to help the dealers cope up with the working capital pressures during this transition?

Anant Goenka: We have communicated with them that during the transition times if there was any tax loss that they incurred as a result of holding earlier stock we would help them out in any way. But I do not think it will have any financial impact really on us, because generally we have managed the entire stocking operation quite well. So, there is no further financial assistance or anything really that we had to do, it was more of just a confidence building measure saying that do not worry, just do the right thing and we are there to help you.

Nitesh Sharma: Okay. And what is your expectation on Chinese imports going forward, given that anti-dumping on truck bus bias has now been expired, do you see bias imports coming to India in a big away any time soon?

Anant Goenka: No, I think there was truck bus radial anti-dumping duty that has been imposed, I do not think, if I recollect right, there was any duty on truck bus bias which has recently expired. I think we can check and get back to you. But anyways, international production of bias is relatively low. So, what is coming in is largely radial will always grow. Even in China, for example, largely they have moved to radial tyres, there may be some minimal bias production which is there. So, if at all there will be only radial tyres that have been coming in and will continue to come in, but certainly at lower levels since anti-dumping duty on truck radials has been there.

Nitesh Sharma: Correct. And do you think this will benefit us in the truck bias segment in terms of volumes, given that fleet operators are enjoying higher mileage post GST and hence the demand for truck bias should in the second half be very strong?

Anant Goenka: I think it will benefit the truck bus bias segment to a certain extent, it will directly benefit truck radial more, but we are a little capped on capacity side. But overall, if we look at the truck segment, we are talking about Chinese tyres reducing which is a low-cost segment, so certainly some of those will move to bias category.

Moderator: Thank you. We have the next question from the line of Bharat Gyani from BNP Sharekhan. Please go ahead.

Participant: I just had one question, what is your overall CAPEX plan for this year and next financial year as well, considering all the projects that are going on?

Kumar Subbiah: See, this year our CAPEX exact cash flow would be in the range of 350 to 400. But in terms of CAPEX orders we would have finished a little over Rs. 1,000 crores or so. Between two years, that is 2017-2018 and 2018-2019 together, our overall CAPEX would be in the order of about Rs. 1,600 crores to Rs. 1,800 crores, in that range, in terms of outflow.

Participant: And given the Greenfield CAPEX that we are doing for the passenger vehicle category and you talked about OTR segment capacity increase as well. So, can we assume that for FY20 also the CAPEX would be, because if I take the average CAPEX it will be about Rs. 800 crores to Rs. 900 crores given the indication what you gave now. So, FY20 also there would be a similar kind of number or FY20 we will see tapering down of CAPEX?

Anant Goenka: No, total Rs. 2,800 crores of CAPEXdoes not include specialty. So, in the next three to five years we would make that Rs. 2,800 crores. In addition to that, it is good to assume that we would have another Rs. 700 crores to Rs. 800 crores in the year three also, but without excluding specialty.

Participant: So, if I take this Rs. 800 crores - Rs. 900 crores per year for FY18 and FY19, it includes everything? So I am trying to understand FY20 will be similar number or it will be more than this?

Anant Goenka: See, in the next two years I said approximately in the range of Rs. 1,400 crores to Rs. 1,600 crores. In the following year we would have another Rs. 800 crores of CAPEX.

Participant: So, total would be Rs. 1,600 crores for FY20?

Anant Goenka: Yes, Rs. 2,400 crores to Rs. 2,600 crores, balance out of the Rs. 2,800 crores would be spent in fourth and fifth year.

Participant: So, FY20 total CAPEX would be about approximately Rs. 1,500 crores, is that right?

Anant Goenka: Yes, correct.

Moderator: Thank you. We have the next question from the line of Amin Pirani from Deutsche Bank. Please go ahead.

Amin Pirani: Just want to revisit this CAPEX, so you mentioned that on an outflow basis CAPEX would be around Rs. 1,400 crores - Rs. 1,600 crores over 2018 and 2019?

Kumar Subbiah: Yes.

Amin Pirani: Out of which you said Rs. 300 crores to Rs. 400 crores will be for this year for 2018?

Kumar Subbiah: Yes, true, in terms of cash outflow.

Amin Pirani: So, in terms of cash outflow next year is a much bigger number, close to Rs. 1,000 crores?

Kumar Subbiah: Yes, because in the coming year we would have commissioned our TBR plant and may be towards end of the following year, as Anant indicated, PCR also would have got commissioned.

Amin Pirani: Okay. So, as you said, the Rs. 2,800 crores obviously does not include the specialty, so including specialty how much would be the CAPEX separately?

Kumar Subbiah: Specialty, additional CAPEX has not been approved, as and when it is approved I think the additional CAPEX for specialty would be close to about Rs. 400 crores.

Amin Pirani: Okay. And just wanted to go back to the truck bias, what would be our capacity utilization right now, broadly?

Anant Goenka: Capacity utilization for truck bias will be about 80%.

Amin Pirani: And if I look at this segment, obviously over medium-term to long-term we would see declining volumes. But say in the next one to two years if the replacement demand for the truck tyre industry comes back as a whole, do you think that bias could also benefit and we could see say mid-single-digit growth or that is not something that is possible?

Anant Goenka: I think it is quite unlikely. I think even if it bounces back the level of negative growth may reduce. So, I think growth is looking very unlikely, it could go that one year you will have zero growth or something like that. So it is hard to predict, but long-term it is going towards negative growth. Now one year here and there things can change.

Amin Pirani: So, even on the replacement side most of the growth will happen on the radial only, OEM anyways is radialized almost entirely, you are saying even on the replacement it will be mostly radial?

Anant Goenka: Yes. There will be of course bias sell for a long time.

Moderator: Thank you. We have the next question from the line of Chintan Gupta from Way2Wealth. Please go ahead.

Chintan Gupta: Sir, what kind of gross margins can we expect in FY18?

Anant Goenka: We would not be able to share with you our gross margin data. But I would say, as I said, I will give you some indication on the raw material price, as I said, largely have been stable. I think pricing is something which is unpredictable but based on that I would say this will work out.

Chintan Gupta: So, it would be same as Q2, 39% about for the rest of the year?

Anant Goenka: We would not be able to answer that.

Chintan Gupta: Okay. My second question pertains to your Chennai expansion plan, could you share some more details about this?

Anant Goenka: We are largely setting up passenger car facility out there in phase one.

Chintan Gupta: It is only for passenger car?

Anant Goenka: Yes, in phase one at least. That is going to be 150 tons per day and will require an investment of slightly over Rs. 1,000 crores, may be around Rs. 1,200 crores or so.

Chintan Gupta: Okay. And by when will it be commissioned?

Anant Goenka: It will take at least a little bit over a year's time from now, because we have just acquired the land, it will take a year and a half from now approximately. Around quarter one of 2019.

Chintan Gupta: Okay. And sir, would it be possible for you to quantify your market share with HMSI?

Anant Goenka: No, we would not be able to share that.

Chintan Gupta: Okay. And are we supplying for new Honda Grazia, if you can share?

Anant Goenka: Yes, we are. That has launched, so as I shared that is launched on CEAT.

Chintan Gupta: Okay. And what would be the income tax rate for the entire financial year 2018?

Kumar Subbiah: It is likely to be in the range of around 32% to 33%.

Moderator: Thank you. We have the next question from the line of Romil Jain from JM Financial. Please go ahead.

Romil Jain: Sir, I have a few questions. One is, can you let us know when will the Halol and Nagpur commissioning happen?

Anant Goenka: Yes. So, both the plants have been commissioned, but ramp-up is underway. So, Nagpur would be slightly over 50% utilization, not utilization but 50% of peak capacity at this point of time, it is a 120 tons per day plant, we have set about 60 tons - 70 tons per day kind of approximate utilization. And that will ramp-up over the next four months' time to full capacity. With respect to Halol also, I would say we are at about 70% kind of utilization from its peak capacity, not utilization at current level but from peak capacity.

Romil Jain: So, since we have the capacity now, hence we are getting traction on OEMs also, as you mentioned.

Anant Goenka: Yes, I think the question at that time was largely on the passenger car side, so while on two-wheeler side and truck side we have always had good capacity specifically. But on the car side we have limited capacity.

Romil Jain: Right. Sir, also with the commissioning of Halol now and Nagpur, and they are ramping up, what kind of market share we will have in passenger vehicle and two-wheelers, both these categories?

Anant Goenka: Yes, so our motorcycle market share or two-wheeler market share approximately is somewhere between 27% and 30% today. So, with the capacity ramping up is one part, but we really need to make sure we continue to outperform the market in terms of sales**.** So, while our capacity may be able to take us to even say 35% hypothetically, but sales have to go up to that kind of level. So, our admission is of course to take it up closer to 35% levels. But now where will it reach, tough to say, it really depends on market growth and how we are able to take advantage of that. On the passenger car side, we are today at about close to 10% kind of levels, our goal is of course again to ramp-up faster this year, and we are seeing good traction from the market here. In my view, capacity could be a constraint on the passenger car side.

Romil Jain: Okay. And just this CAPEX that you mentioned, Rs. 2,800 crores over the next three to four years, that would not include the new Chennai passenger vehicle, right?

Anant Goenka: That includes.

Romil Jain: It is including that?

Anant Goenka: Yes.

Romil Jain: Okay. And last question sir, if you can give us the current passenger vehicle and two-wheeler capacity, excluding Halol and Nagpur, so that I can get the total capacity?

Anant Goenka: So, on passenger car capacity excluding Halol means, all our passenger car has facility in Halol. Our phase one was about 70 tons per day of passenger car facility, we added about 120 tons per day.

Romil Jain: And two-wheeler?

Anant Goenka: Two-wheeler, in terms of lakhs of tyres we have a capacity of about 12 lakhs to 13 lakhs capacity we had earlier, we added about another 10 lakh tyres per day. Out of that new expanded 10 lakhs, as I said, we are about may be 4 lakh to 5 lakh tyre capacity.

Romil Jain: This is per month, right, 10 lakhs?

Anant Goenka: Per month.

Moderator: Thank you We have the next question from the line of Chirag Shah from Edelweiss Capital. Please go ahead.

Chirag Shah: Just a clarification, first on the market share, these are OEM market shares or these are overall aggregate market share?

Anant Goenka: This is more in fact the replacement market share, because that is what is little bit more important to us. If you add OEM, our OEM market share would be a little bit lower, versus say to 28% to 30% may be this will be somewhere between 23% to 25% kind of levels, or 22% to 25%. So, on an average I would say it could be may be 27% - 28% on average.

Chirag Shah: The second question was that if I look at two-wheelers and passenger car, today we can say passenger car business is half the size of two-wheelers for us, or may be slightly lower than that, around 46% - 47%. Is it possible that in next three to five years the passenger car business can become as big as two-wheeler business for us?

Anant Goenka: Absolutely, it can.

Chirag Shah: And are our capacities getting aligned to that kind of opportunity or capacity is not necessary getting aligned to that kind of opportunity?

Anant Goenka: So, it will get aligned to that kind of opportunity because I think the market of passenger car, I am assuming that we will get the success that we want, the market of passenger car is larger than the two-wheeler market size. And therefore if you assume that we are able to gain market share on the passenger and even not reach that kind of level that we have on the two-wheeler side, I would say in terms of tonnage or percentage terms it can be very close. So, I would say two-wheeler is about 28% to 30% of our sales, passenger car can clearly reach 20% of our sales plus. So, may be somewhere between 24%, 28%, that kind of level it can reach.

Chirag Shah: And on this CAPEX front, is there any preponement of the CAPEX versus the original plan, because there seems to be a significant jump in next year for CAPEX. So, is there any preponement in the CAPEX program that you had earlier guided over that five year 2,800 crores CAPEX that you had?

Anant Goenka: Not really. I would say actually largely things remain on track, there is no major change that has happened.

Chirag Shah: So, in 2018 the CAPEX would be around Rs. 500 - Rs. 600 crores and next year it would be around Rs. 800 crores to Rs. 1000 crores, right?

Anant Goenka: Yes, I think that is what Kumar said.

Chirag Shah: And in terms of capitalization?

Kumar Subbiah: See, capitalization we are not able to comment now because capitalization will happen only after first tyre is rolled out and it happens progressively. So, that was the reason I mentioned about cash outflow. So, both the years put together in the range of Rs. 1,500 crores to Rs. 1,600 crores, earlier we had given an estimate of Rs. 600 crores to Rs. 800 crores per annum, which is what we are sticking to at this point in time also. So, capitalization will depend on when the tyres get sold out. So, whatever we incur in year one and year two may be most likely will get capitalized towards later part of year two or most part of year three, that is the way it will happen.

Chirag Shah: Fair point, this helped us to understand how should we look at depreciation charge, this was really helpful.

Kumar Subbiah: No, depreciation, I do not think in the current year we will have any depreciation charge relating to the Rs. 2,800 crores CAPEX. The depreciation impact in the coming year would be very marginal because what is likely to get commissioned in the coming year is the TBR and that will be later part of the year, so therefore depreciation impact will be small.

Moderator: Thank you. We have the next question from the line of Mayur Milan from India Nivesh. Please go ahead.

Mayur Milan: Could you help me with what would be your market share in the two-wheeler space?

Anant Goenka: I just shared that, market share in two-wheeler space would be somewhere 28% and 30%.

Mayur Milan: Alright. And I was looking at the overall change in rubber price, so I believe our average cost for the quarter would be anywhere around Rs. 120 and Rs. 125?

Anant Goenka: No, I think overall rubber is somewhere between Rs. 130 - Rs. 135 is the current ex-cochin price. Largely there has not been a major change, it has been fluctuating between Rs. 127 and Rs. 135 ex-cochin. So, that is the range at which rubber has been for the last three months and even now. This is RSS 4 ex-Cochin price.

Moderator: Thank you. We have the next question from the line of Basudeb Banerjee from Antique Finance. Please go ahead.

Basudeb Banerjee: A couple of queries. One, this quarter one can see quite big demarcation in margin revival between the truck tyre intensive companies and diversified tyre companies. So, if you can highlight the drivers of margin revival and specific pockets of pricing for lack of discounting in that direction.

Anant Goenka: Sorry, could you repeat? Are you saying that between quarter one and quarter two what has caused the reason for margin change?

Basudeb Banerjee: No, I am saying that the diversified tyre players have shown much better revival in margin, including you, compared to truck tyre intensive companies.

Anant Goenka: It is more about our case, I do not about the other cases. But my guess is it could be because of product mix and market mix, depending on each player or person where OEM has grown or replacement has grown, that would have some impact, and then of course, the product itself where the margin differential is there. But I can broadly share that in our case what has happened, I cannot share so much on the cases of the others.

Basudeb Banerjee: And sir, from next two quarters perspective how do you see the raw material market panning out compared to present quarter?

Anant Goenka: As I said, I think raw material will largely be stable, because as with respect to quarter three whatever had to be done is largely done, we are already on 15th November and we are talking about barely 45 days for quarter three to be over. And quarter four also, I would say, usually if you look at a three-month kind of cover that is there on raw material buying, we are kind of secure for the rest of the year in terms of raw material largely being stable.

Basudeb Banerjee: So, quarter three already half of the quarter done, so will it be right to assume, are you thinking the rates remain status-quo that your quarter three will be similar to quarter two?

Anant Goenka: That is right.

Basudeb Banerjee: And no pricing actions down the line, anything in plan?

Anant Goenka: That is difficult to give an answer, it is a comparative market, depends on how competition behaves, what are the needs at that point of time.

Moderator: Thank you. We will take the last question that is from the line of Sunil Kothari from Unique Investments. Please go ahead.

Sunil Kothari: What I want to ask is, during last three, five years, the way we have taken the effort to building a brand, quality improvement, awareness, will it make a large difference in terms of your product and price acceptance at OEM and replacement, do you see those change helping us to maintain this type of 40% plus gross margin. Anything can you talk about from longer term point of view?

Anant Goenka: Sorry, could you repeat the question again?

Sunil Kothari: Anant, my point is the way we have taken effort to building our brand, improve quality of the product, the awards we are getting. Will it be possible to maintain these types of gross margins which we are achieving, whatever be the situation, may be not on a quarterly basis but on a year-on-year basis that we can maintain this margin because we are providing some quality product with good brand?

Anant Goenka: Absolutely. I think the awards etc is just an outcome of the efforts that has been put in or what we are doing towards quality and our product and distribution side. So, I think those are the key things that really are affecting overall business, growth, etc. so, that is something where we are continuously focusing on, trying to solve customers' problems, trying to make sure we are at the forefront of distribution on the passenger car and two-wheeler side, making sure our truck products and any challenges that we face are overcome very quickly. So, I think all of those things certainly are helping in a big way, making sure that we are able to continuously improve, come up with new ideas, innovation. So, I think these are the things that we will keep working on and I think it is more of a hope that we continue to improve and maintain good margins, this is what I would say is where these initiatives are largely helping us.

Sunil Kothari: And sir, normally these are providing volume numbers, is it possible this first half what is the volume number in terms of tonnage?

Anant Goenka: Quarter two volume growth was about 1% to 2% kind of growth.

Sunil Kothari: And do you expect higher volume growth compared to first half in the second half of this year will be far ahead in terms of volume growth compared to first half?

Anant Goenka: Yes.

Moderator: Thank you. Ladies and Gentlemen, that was the last question. I now hand the conference over to Mr. Tushar Chandra for closing comments. Thank you and over to you, sir.

Tushar Chandra: Thank you very much. On behalf of ICICI Securities, thank you very much to the management, Mr. Goenka as well as Mr. Subbiah for taking the time to do this. And thank you very much to the investor community as well for logging in. With that I will log off, thank you very much.

Moderator: Thank you very much. Ladies and Gentlemen, on behalf of ICICI Securities, that concludes this conference. Thank you for joining us. And you may now disconnect your lines.