



“Tube Investments Q1 FY-19 Earnings Conference
Call”

August 16, 2018



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MODERATOR: MR. KASHYAP PUJARA, AXIS CAPITAL LIMITED



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Moderator: Ladies and gentlemen, good day and welcome to the Tube Investments Q1 FY19 Earnings Conference Call hosted by Axis Capital 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. Should you need assistance during the conference call, please signal an operator by pressing ‘*’ then ‘0’ on your touchtone phone. I now hand the conference over to Mr. Kashyap Pujara from Axis Capital Limited. Thank you and over to you sir.

Kashyap Pujara: Thank you Sandford and good morning everyone and thank you so much for standing by. It is a great pleasure to have with us the management of Tube Investments Limited for the Q1 FY19 Earnings Call. From the management side, we are represented by Mr. Vellayan who is the Managing Director and Mr. Mahendra Kumar who is the CFO. Without taking too much time, I now hand over the floor to Mr. Vellayan. Over to you sir.

Vellayan Subbiah: Thank you Kashyap. Good morning everybody. Welcome to the call, I will just take you through brief highlights of the quarter and also broadly outline our strategy for the future and those are the two main agenda that I will have and then we will turn it over to you for questions.

Quick highlights, we have had revenue of 1362 crores which has been the highest ever we have had in a quarter with a 20% growth over Q1 of last year which is net of excise duty. The highest ever PBT of 82 crores which is a growth of 57% over last year. Our ROCE is improved to 19% and our free cash flow to PAT ratio was at about 149%.

With that I will just briefly outline what we are looking to do as a company going forward and then turn it over to you for questions. Broadly we are setting aggressive financial targets for ourselves and these targets are going to be based on four metrics, what we are looking at as a target is ROCE, PBT as a percentage of sales which was around 5% when we started and we are looking at significantly increasing that. We are looking at increasing sales growth quite aggressively and our fourth financial target is to improve free cash flow as a percentage of PAT, so we are in general going to become a lot more cash flow focussed than we have been in the past.

The good news is that we have been able to reduce our net debt in the first quarter itself and we have been able to bring that down to 605 crores from 687 crores at the beginning of the quarter, so that has done well from a free cash flow perspective. So broadly to achieve these objectives, there are three tracks that we are pursuing. The first track is around strengthening the core which is improving the performance of the current operations of our business. And we are spending approximately 60% of our time right now on this track.



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The second track is around identifying growth potential for our current businesses and we are spending about 20% of our time on that track and the third track is to identify new business for TI and we are spending about 20% of our time on that track.

The third track is to reduce cost mainly in the areas of sourcing, scrap realization, logistics, manpower for which the balance 20% time is spent by the management.

I will spend a little time talking about what we are doing to strengthen the core which is to improve the performance of current operations.

Basically, starting in March, we put in place set of teams. We have got almost 70 teams now working across the five business units and they are working across seven areas of performance improvement.

- The first is revenue enhancement.
- The second is sourcing.
- The third is additional realization from scrap.
- The fourth is logistics cost optimization.
- The fifth is finance cost reduction.
- The sixth is quality and productivity improvement.
- The seventh is fixed cost reduction.

So, that is, these teams which have very specific areas of improvement are becoming the core to improve ourselves. And we are happy to answer, if you have more question on the seven areas of performance. And obviously like we said again we are getting very fixated on how we generate cash and how we use cash by looking at working capital, capital expenditure and any other usages of cash because we really want our debt position to be lower than net working capital as quickly as we can, so, that is going to be a fairly near term objective for us.

Now with that I will stop, but we will be happy to go into any questions what you might have from your side. Thank you.

Moderator:

Thank you very much sir. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Kashyap Pujara from Axis Capital Limited. Please go ahead.

Kashyap Pujara:

Sir, just a couple of questions to understand the strategy that you just outlined., we are a company with 4500 crores of revenue from the current capacity that we have at hand. What is the kind of revenues that we can actually look at from sweating out of existing asset and room for improvement as far as margins are concerned be it through operating leverage or the cost efficiencies that you just spoke of. So, that would be the first part of the question and the second would be that over a three to five-year roadmap based on new products and outside the



core that you spoke of, what can be the revenue growth trajectory that one can look at over a three to five year of perspective?

Vellayan Subbiah:

So Kashyap your first question general belief is that we should be able to go up by about 20% in revenue with current capacity. Then obviously the question is how much incremental CAPEX is required to generate additional revenue growth in the existing businesses. That is an exercise we are going through now. We have to look at how much CAPEX we will have to spend to keep going at a fairly good clip right obviously kind of this first quarter where we have seen 20% growth that has been good. But obviously what we need to see is how much capital we need to sustain close to this level of growth. Your second question on how much we could potentially kind of keep growing at our perspective is that we should be able to push in the high teen. And so that is the intent what we are looking at in terms of new businesses though, our businesses that are less capital intense than the current business mix. Because we do believe that our business mix currently is fairly capital intensive and we want to mix it up with businesses that are not as capital intensive as we go forward.

Kashyap Pujara:

Sure. That would be interesting, and second would be if I were to take a three to five year view what is the kind of operating margins that the business wants, to achieves your definition of steady state. What is the kind of operating margins that one could look at because obviously we are lower than what are peak margins were at one point and that is obviously because of the Cycles. They are still not contributing. So, explain how that side of business will turn and where the steady state should be.

Vellayan Subbiah:

So Kashyap, again our first objective is to move and to get to double digit margins that we want to do as quickly as possible and ideally in less than the kind of time frame that you talked about. So, once we get there, I would say, then we can look at the next objective for ourselves but definitely we do things so that there is a significant opportunity to improve PBT in this business. And when I say double digit, I mean for PBT, so I think, just in general in terms of language, we will stop discussing things like EBITDA. We are going to be very focussed on these four metrics. So PBT focus, we have to make the PBT to double digit as quickly as possible.

Kashyap Pujara:

That is an encouraging thought. I will just wait and just check for more questions, Stanford could you just check for questions please.

Moderator:

The first question is from the line of Vipul Shah from Sumangal. Please go ahead.

Vipul Shah:

What is the volume of large dia in this quarter and what was it in the last quarter of last financial year.

Vellayan Subbiah:

We have had a volume growth of excess of 50% so basically, 60% growth over the last quarter and basically now that business is profitable at a PBT level.



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- Vipul Shah:** 60% when you say it is sequential or year over year sir.
- Vellayan Subbiah:** Year over year.
- Vipul Shah:** And any reason for some turnaround in Cycle business. Our trade volume has improved significantly in this quarter.
- Vellayan Subbiah:** Yes. So basically, in terms of the Cycle business, obviously the first quarter is a good quarter because trade is strong. But we are also going to look at a lot of the performance improvement opportunities in that business and our sense is that, that is going to take this year. The rest of this year will be very focused on looking at what we can do to improve the performance of that business. We are very bullish of getting to the performance improvement and therefore improving the overall business, but we do believe that it will take a little more time.
- Vipul Shah:** So what I try to understand sir is, the turnaround that we have in this quarter, is it sustainable over coming quarters?
- Vellayan Subbiah:** At these levels of profitability we do believe that we will be able to grow that business, but we do think that business has to be more profitable than the current level of profitability.
- Vipul Shah:** Okay. And what further steps are we were taking to improve the profitability in the Cycle business because that is the only weak link.
- Vellayan Subbiah:** Like I said, I talked about all of those areas. So, within the seven areas of focus logistics cost optimization for example it is a huge opportunity we look at, for Cycles. We are looking at revenue enhancement. We are significantly increasing the channel. So, for example, we will significantly increase the exclusive outlets that we have, the track and trails, so increasing that channel, looking at what we can improve in terms of our share in the MBO channel and also the other stuff, which are the new channels that are picking up, PBS, E-commerce. Significantly, the revenue enhancement side is important and so is the logistics side. We are also looking at significant quality and productivity improvement where we see a lot of opportunity for our two production operations. So, apart from those three areas, sourcing is the fourth area. We are looking at how we can improve our sourcing by moving it closer to the vendors. Since a lot of vendors tend to be in the Northern belt, moving our sourcing and more of our operations to that area, we can capture that benefit as well. So, across those four areas, we do see significant opportunity in this business.
- Moderator:** Thank you. The next question is from the line of Bharat Sheth from Quest Investments. Please go ahead.
- Bharat Sheth:** You have set a very big target for our company, particularly on PBT, you said that we want to go to double digit as early as possible. So, out of our three businesses, Engineering, Cycle and metal forming, which will help in achieving that faster pace? Second question is on identifying

growth for the existing business. If you can highlight a little more on that, that will be really helpful.

Vellayan Subbiah:

So first in terms of your question on which business, obviously Engineering is our largest business today and so significantly drives the performance and we see a lot of opportunities there, like we said across the seven areas to improve the performance of the Engineering business itself. So, that is the answer to your first question. In terms of where revenue enhancement can come from I think revenue enhancement can come across areas right, pretty much everything we look at today. If you take the chains business, we are seeing significant demand both in OE and in the aftermarket. The aftermarket is growing significantly and we want to increase our market share there. So, both in OE and aftermarket, we are basically been running almost flat out for the first quarter. And we see that trend continuing, and I think even if we enhance capacity there is enough demand for that. Definitely we see a lot on the drive chain side on the two wheelers from that business. So that itself can give us a lot. The second is fine blanking where we have seen significant opportunity to enhance sales. We are doubling our capacity in that business, so, that is going to start yielding significant sales growth as well. The third is in the metal forming. We also have a business that gets into railway coaches. That business is also showing very strong potential for growth. And finally, on the core Engineering business we are seeing significant demand both on front-forks for both domestic and export markets in Asia. And some of our other businesses in the Engineering side as well, like we said, large dia is seeing a significant demand on some of the hydraulic tubes that we are making. So, across all of our areas, we are seeing good potential for growth. The market is definitely strong and that has been a huge advantage for us and we do see some of that strength continuing, going forward.

Bharat Sheth:

Great sir. I just want to understand that in Metal Forming, chain part and as well as in this Engineering side, front-fork, how much of our business is dependent on the two-wheeler? Of course, two-wheeler in last two quarters is doing wonderfully well. So if you can give a broader color and what exactly we are doing to de-risk from there?.

Vellayan Subbiah:

Sorry I am trying to, de-risk from?

Bharat Sheth:

Two-wheeler business. Our larger dependence on the two-wheeler industry in the case of chains as well as in front-fork also.

Vellayan Subbiah:

Good point. So, like we said, that is why we are beginning to identify new growth areas for TI which will move away from that market. But it has only been a quarter, so it will take us a little more time to identify and once we identify we like to seed those areas, test them, ensure they are growing well before we kind of go out and openly start calling them successes. But we are looking at that, and we are spending significant portion of our time. Looking at new potential opportunities, that we can get into, that will de-risk from the two-wheeler business.



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- Bharat Sheth:** Is it possible to give some color on how much your current business is dependent on the two-wheeler?
- K. Mahendra Kumar:** Across businesses, if you take auto sector separately, it will be like 50-50. 50 Cycles out and look at only auto business.
- Bharat Sheth:** And Metal Forming also, apart from Railways, are we looking any other opportunity?
- Vellayan Subbiah:** Yes, we have the door frame business which is also growing well.
- Moderator:** Thank you. The next question is from the line of Arul Karthik from Karvy Stock Broking. Please go ahead.
- Arul Karthik:** And I would like to take the bookkeeping question, for Cycles can you give me the volumes.
- K. Mahendra Kumar:** 8.6 lakhs in trade business. Another 1.9 we did in institutional segment. So total of about 10.5 lakhs
- Arul Karthik:** Speciality breakup.
- Vellayan Subbiah:** Speciality, we are seeing some growth.
- K. Mahendra Kumar:** 6.6 out of 8.6 is from speciality segment.
- Arul Karthik:** And we have seen a growth in this segment?
- Vellayan Subbiah:** Yes.
- Arul Karthik:** And what about the CAPEX in this segment particularly?
- Vellayan Subbiah:** It is very low.
- K. Mahendra Kumar:** Cycle is very low.
- Arul Karthik:** Alright. Next is Engineering segment. Volumes between tubes and strips?
- Vellayan Subbiah:** Like we said, large dia had a growth of about 62%, 26% in tubes and 19% in strips.
- Arul Karthik:** Okay. And this 26% growth is inclusive of large dia?
- Vellayan Subbiah:** No. Exclusive of Large Dia.
- Arul Karthik:** And export contribution in this segment?



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- Vellayan Subbiah:** I do not think we share that specifically. Just to give you a sense, overall. Given where things are today, I say, we are extremely bullish on the potential opportunity for all three lines of business for a couple of reasons. One is because we do see the market helping us. The second is, we do see performance improvement potential also across all three. So those two factors combined, gives us a lot of confidence in terms of where we can go with it this year. The second angle, of course is, we just want to bring lot more cash flow focussed, so that we can start paying down our debt and manage our cash flow much more efficiently as a company.
- Arul Karthik:** Sir, in the Metal Forming division, volumes for door frames and chain.
- K. Mahendra Kumar:** We had about 21% growth in terms of Sales Value.
- Vellayan Subbiah:** So, 21% overall growth and we don't share it at segmental level.
- Arul Karthik:** Okay sir. Sir you talked about 5 SBUs with 70 teams working in these 5 SBUs so it will be Cycle, Engineering, the Metal Forming and Gear and what would be the fifth segment?
- Vellayan Subbiah:** Actually, within Metal Forming, we have two SBUs. One is Chains and Kits and another one is the Door Frames and Coaches.
- Arul Karthik:** Alright. The key indicator, we would like to look at this like a PBT margin, are there any hard targets per ROCE, sales growth and the SSC?
- Vellayan Subbiah:** Yes, there are internally, and I think what we will do is, as we get more confident with them over time, we will declare them externally as well.
- Moderator:** Thank you. The next question is from the line of Sagar Parekh from Deep Finance. Please go ahead.
- Sagar Parekh:** Sir, what would be our CAPEX target for the next two years and which are the areas where we are increasing our capacity? You mentioned Fine Blanking, where you said you are doubling the capacity. So, any other areas and what would be our total CAPEX?
- Vellayan Subbiah:** So, this year we are looking at keeping CAPEX in the order of about 200 crores and ideally next year, CAPEX will be lower than our depreciation.
- Sagar Parekh:** Okay. So, next year then, you wouldn't be increasing the capacity anywhere, it will probably be the maintenance CAPEX?
- Vellayan Subbiah:** We will, CAPEX lower than or equal to depreciation. We can still significantly increase capacity. That is not a constraint.



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- Sagar Parekh:** And in terms of which business areas would you be increasing the capacity for the next two years?
- Vellayan Subbiah:** There are two biggest areas that we will consume right now which are going to be Engineering business and Fine Blanking.
- Sagar Parekh:** And within Engineering, will it be any particular product segment?
- Vellayan Subbiah:** Obviously large dia does not need that much more right now. We are expanding our operations in Rajpura and that will take up some CAPEX. So, basically, with two sets of expansion, I think, we will broadly be well-balanced across the North, the West and the South, in terms of our production capacity on tubes and that will help us significantly because it will also help to bring down freight cost and make us more competitive in each of those three zones.
- Sagar Parekh:** And what would be the capacity utilization of the large diameter tubes now?
- Vellayan Subbiah:** So obviously it varies from ERW side and the CDW side. The CDW side we are getting close to about 80-85%. The ERW side is still very small, we are still at a low percentage.
- Moderator:** Thank you. The next question is from the line of Kashyap Pujara from Axis Capital. Please go ahead.
- Kashyap Pujara:** So, just a follow up question on the Shanthi Gears, optically, the company is still operating much below of what the actual potential of the company is, could you give brief glimpse of how you see that business overtime, where are we in that business currently?
- Vellayan Subbiah:** Again, we see a lot of opportunity to improve performance there and you have seen this quarter's performance. So there is an improvement. I think, basically, what we have to look at, is very aligned with that one performance the company had in 2009, the peak performance here and all metric seem to be set around that. Reality is that the business has changed significantly since then, and competition has also changed significantly since then, which has created more pricing pressure on the business. Predominantly, I think we have one competitor that has significantly increased capacity, though the balance sheet may not be as strong, they basically are looking at creating a bit more pricing pressure in that business than we would like to see. But we still see significant opportunity to improve that business both from a revenue enhancement perspective and cost perspective. I just think that at this stage, we won't give any specific numbers, but we definitely do see improvement opportunity in that business over time.
- Moderator:** The next question is from the line of Suchit Kawatkar from ICICI Lombard. Please go ahead.
- Suchit Kawatkar:** I would like to know breakup of short-term and long-term debt on standalone and consolidate basis.



- K. Mahendra Kumar:** So long-term is 450 crores and short-term is about 268 crores but then we also have investments of about 113 crores, so if you see the total net debt it will be about 605 crores.
- Suchit Kawatkar:** Okay. And this is standalone?
- K. Mahendra Kumar:** Yes.
- Suchit Kawatkar:** And on consolidated basis?
- K. Mahendra Kumar:** Consolidated, we have debt only in Sedis and that is about €13 million. Shanthi Gear is in debt-free as you know.
- Moderator:** Thank you. The next question is from the line of Vipul Shah from Sumangal. Please go ahead.
- Vipul Shah:** At consolidated level, what is the percentage of revenue we are getting from auto sector and within auto, can you bifurcate between two-wheelers and four wheelers?
- K. Mahendra Kumar:** Standalone it is about 75% from auto, excluding cycles. We can reduce another 5%, if you add Shanthi Gears to non-auto segment.
- Vipul Shah:** Okay, so it will be roughly 70%?
- K. Mahendra Kumar:** Correct.
- Vipul Shah:** And within auto can you split it between two-wheelers and four wheelers?
- K. Mahendra Kumar:** Yes, like what I said earlier, if you see across the segment it is more or less 50-50.
- Vipul Shah:** And lastly sir what should be our market share in Engineering Tube business?
- Vellayan Subbiah:** Again we do not share market share data and some of it is even tough for us to determine so we do not share that data publicly.
- Moderator:** Thank you. The next question is from the line of Kashyap Pujara from Axis Capital. Please go ahead.
- Kashyap Pujara:** Sir, optically, if I look at the growth strategy that you outlined or the endeavor that you headed into overtime, and with the margin expansion at the PBT level, it is quite obvious that asset turns over time would improve because incrementally your mix would tilt towards higher asset turn businesses or lower capital-intensive expansions. And with the rising margins, you would have reasonably strong free cash flows. Now, if I see historically, tube investments has always been very strong on cash flows right from the past. In fact, this company seeded the Financial Services business which has created tremendous value for shareholders overtime. Now, given



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that the structure is now separate, but the free cash flow profile of the company will only improve from here on, given your growth strategy, how do you look at distribution of free cash? Obviously, you will have some investment to sustain the mid-teen kind of growth. But keeping that apart, can we look at higher payout or more adjacencies which we can expand into? how you think on think on those lines?

Vellayan Subbiah:

Kashyap, first we have got 600 crores in debt to pay down. So, that will be the first focus. And if you take natural earnings, if you take just at a PAT level, that will take a little while to be paid up right. So obviously the first focus is just to pay down the debt. Now beyond that the way, I look at the market, there is significant opportunity for growth in India and the intent will be to pump that into businesses where we see significant growth potential. Like I said, the biggest thing is that the criteria for those businesses will be slightly different from the criteria of our existing businesses. But beyond that, the intent is to create significant growth in the business through a combination of our existing business lines and new business lines that we add to the mix over time. So the free cash flow usage will predominantly be for those two areas.

Moderator:

Thank you. As there are no further questions from the participants, I now hand the conference over to Mr. Kashyap Pujara from Axis Capital for closing comments.

Kashyap Pujara:

Thank you so much everyone for being there on the call and thank you to Mr. Vellayan and Mr. Mahendra Kumar for answering all the questions.

Moderator:

Thank you very much Sir. Ladies and gentlemen, on behalf of Axis Capital Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.