"Piramal Glass Limited Q2 FY'13 Earnings Conference Call"

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MANAGEMENT: MR. SANDEEP ARORA, CFO
MR. VIJAY SHAH, DIRECTOR

Moderator: Ladies and gentlemen, good day and welcome to the Q2 FY'13 Earnings Conference Call of Piramal Glass Limited. We have with us today Mr. Vijay Shah, Director and Mr. Sandeep Arora, Chief Financial Officer, Piramal Glass Limited. As a reminder for the duration of this conference, 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 this conference, please signal an operator by pressing "*" and then "0" on your touchtone phone. Please note that this conference is being recorded. I would like to hand the conference over to Mr. Sandip Arora. Thank you and over to you Sir.

Sandeep Arora: I welcome you and I would request Mr. Vijay Shah to give you his brief comments on the business and the industry scenario.

Vijay Shah: I know it is a festive season and lot of people are busy with Pooja and other things, but you all found the time to be with us. Let me first give perspective on what is happening with the industry. First let me touch base on cosmetic and perfumery industry and the premium market. So, the premium market which is primarily concentrated in Europe and US, I have just been to a very important International Fair, which is called LUXE PACK Luxury Packaging Fair in Monaco and met many industry leaders that are my competitors to understand what is happening from the customer perspective.

What I am seeing currently in the market is a little bit of recessionary trend, almost similar to what was happening couple of years back when the last downturn happened, leading to excess capacity in the industry in Europe and US and even forcing some players to drop prices and there is a little bit of fight going on for gaining share from each other. In this environment, what we are finding that the customers have slowed down in terms of new product launches. They are adding flankers. For us, we continue to grow in the market in the premium segment. Only thing is it makes our task slightly more difficult. So, if you look at a numbers we are still growing in the range of 30% the premium market out of India and overall almost 20%.

Coming to the mass market, which is more concentrated in Middle East, India to some extent in Turkey and these countries, we do find a little bit of slow down even in this market, but here what my experience is like last time couple of years back this gets corrected very fast. So, currently they have mentioned Middle East crisis and global slow down as the reason, but I expect this will be corrected soon. The Pharma market is doing fine. It continues to grow globally and in India also it is stable.

The specialty foods and beverages market, again in US and Sri Lanka is growing. In India, I think, it is more worthy that this market is a filler market for us when we add capacity, which we have added recently and to that extent we need to depend in this market until we gradually change the product mix in favour of the right product and customer mix. So, as you know that we have lumpy addition to capacity and linear growth in the market, so in this the short term we do supply to the local market or domestic market.

The domestic beer and liquor market, the food market even in India, there has been massive addition of capacity by competitors locally, almost 25% addition and to that extent there is a lot of pressure in the market and from smaller players have followed up the road. What we are noticing is that we are able to keep our lines running, which is very important in glass industry because of our shear quality and service; however, in this filler capacity, we are not able to get the price that we wanted. So, the prices are under pressure in the local market. This is the overall business environment and as far as the business goes, if I were to think through location wise Sri Lanka is on track, US is almost on track, in India another two locations one is one track and one location is under pressure mainly because of where we have added capacity. So, partly is our own problem that means the new capacity addition is going through a stabilization phase and has not fully stabilized yet and partly the product mix or the prices are not what we would like to get. So, let Sandip takes you through the financial performance and then I will be answering questions that are raised on this.

A pertinent point to note in our numbers is that the exchange rate Dollar Rupee exchange, we are very sensitive to that. It does have impact on our numbers, particularly because of the forward curve that we have done during this year. So Sandeep will try and patiently explain nuances of this issue and bear with us on that.

Sandeep Arora: You would have received the presentation that we would have sent. I will take you through that presentation. We will start from Slide No.4. The Indian operations here in H1 contributed to about 57% and the balance of our International operation US 29% and Srilanka 14% of our total global sales.

Coming to Slide No.6, on the consolidated P&L for Q2, our sales have grown by 28%, a very healthy growth there and the operating EBITDA before the forex loss is 7.8% and the EBITDA margins are at healthy 21. If you see the growth continues from the trailing quarter. We have again grown at about 10% on topline and the operating EBITDA has also grown from 19.8% to 21%, a 16% growth from the trailing quarter.

The PAT is at 8.9 Crores compared to 27 in last year and mainly affected by foreign exchange loss, which I will try and explain as Mr. Shah said. The increase in the interest and depreciation is primarily because of the capacity additions that we did and the relining that we did last year. So, our new furnace of 160 TPD started this year and so interest is primarily because of the spent on the capex and hardly there is any rate impact which would be about 10% of the total increase.

The new furnace, which started and as we spoke last time, had its own teething trouble, it is still to reach its peak, but it has substantially improved versus Q1 and which is showing in the operating performance versus the trialing quarter. The only thing that has subdued as Mr. Shah was explaining on the product mix and the price realization in the current market.

If you go to Slide No.7, on the H1 result, the sales again grew by 23%. The EBITDA in real terms is flat but the margins are at again 20.4%. The PAT at 19.5% is mainly impacted again by the foreign exchange loss out of which 10 Crores is a mark-to-market and interest and depreciation has a similar reason which I explained earlier.

On the key ratios ROCE and ROE are at almost 10%. Book value is at 52. The net sales to net fixed assets are at 1.5. Debt equity is at 2.8, maintained versus last and EPS at current analysis 2.77.

Coming to Slide No.10, C&P as our strategy is at 52% of our total turnover and the balances between the Pharma and the SF&B sections. Sales are growing at a healthy CAGR of 21% over FY 2005 to 2013 and the CNP is growing at 30% which is our prime focus.

Coming to Slide No.13, which gives you a brief on the C&P market, C&P growth in Q2 is 22% and H1 is 17%. The premium growth within that are 50 but this is being subdued because of US, which is flat but India grows very strongly at almost 30% on the premium market.

Moving on to Slide No.15, for the Pharmaceuticals, the furnace is got relined last year and the full impact of that is being reflected here. Also we have a very healthy growth coming from the Type I market although it is a small market, but it is very profitable and it is growing very rapidly. Many of the global pharmaceutical companies are outsourcing their injectable filling to India and so it really keeps a good promise for the future.

Moving to slide No.17 of SF&B, a healthy growth of 18% in Q2 and H1 and this includes the low end SF&B that we do from India in the new furnace and we hope that its stabilizes and gives us a better product mix going further. So, we would welcome any questions that you may have.

Moderator: Thank you very much Sir. We will now being the questions and answer session. The first question is from the line of P. Sahadev from Aadhar Securities. Please go ahead.

P. Sahadev: Could you throw some light on the cost and the margins going forward?

Vijay Shah: I have noticed that last two quarters the costs have remained pretty stable. If you look at the two quarters the input cost both energy, raw materials are pretty stable. The margin would be a function of getting better product mix and better price realization. So, it would improve in the future as we keep tweaking the product mix. As I mentioned earlier that the margins have been under pressure on the mass market or particularly on the product mix of new furnace is because of our using it as filler capacity for supplying to the domestic market which is under tremendous pressure on prices. You must have seen some results of our domestic competing glass companies there were huge financial impact because of the excess capacity in India and margins in their case have come into the red in fact. So, coming to answering your question I would say from here margins would improve as the costs are stable and as yields improve as we go forward.

P. Sahadev: So, what is the kind of margin guidance that you guys are giving for the next fiscal 2014?

Vijay Shah: I do not think we are giving any guidance but Company as whole we used to enjoy 35% EBITDA. I think we were striving to come back towards that.

Moderator: Thank you. The next question is from the line of Rahul Agarwal from Systematix. Please go ahead.

Rahul Agarwal: Can you please throw some light on this forex gain and loss?

Vijay Shah: This is very complicated and sensitive issue. It has been impacting us quarter-on-quarter and creating wide swings in numbers. So I feel that you need to be patiently listening to what Sandip has to explain on this.

Sandeep Arora: Let me explain, there are two major parts to this foreign exchange one is the realized and the other is a mark-to-market. The swing that you see from Q1 and the huge impact in the Q2 is mainly on the mark-to-market. If you remember the March, we closed to Dollar at 50.8, in the June quarter closed at about 55.6 and in the September quarter it closed at 52.86. So, there has been a huge swing in the last day closure and we need to restate our Dollar receivables on the closing rate. This is what has actually swung the whole number if you really see.

Vijay Shah: So, when the Dollar was 50, in March and when it was at 55 in June the debtors were restated at a much higher and got a gain in Q1. Then when it came back to 52.50, it went back. I think in addition to this, we have shared with you in the past that this year, we have got Dollar earnings covered at Rs.49. So, when this exchange rate goes to Rs.55 and Rs.52 and all that we do not enjoy the benefit of that and there is a loss you see in a numbers at the foreign exchange level. This cover is still March 2013.

Sandeep Arora: The other thing is that the margins that you see that we are trying to really manage is also really absorbs any foreign exchange impact so if the Rupee has gone to 55, I have also absorbed that impact into this margin so the margins going forward in the coming years would really improve when these kind of hits are not there and we can actually hit them to our earnings.

Rahul Agarwal: What is pertaining to realized foreign exchange loss?

Sandeep Arora: Those are these forwards that we have taken.

Vijay Shah: There are two important parts in foreign exchange, one is the forward cover, which is realized month-on-month, but as it is realized so the forward covers are at Rs.49 to a Dollar, we lose a every month so that is the realized impact. Then the second part is at the quarter end when we are to restate the debtors and loans at the exchange rate so that place a swing, 50 to 55 it went up 55 to 52.50 or something it went down we do not know what happens in the next quarter.

Rahul Agarwal: What I understand is that the sales when you translate to Rupee you translate it at the present exchange rate and that exchange on difference is 49, you bring it down to forex loss that you realized?

Vijay Shah: Yes.

Sandeep Arora: To your benefit this was actually lower in this quarter because the rate went down versus the quarter one.

Rahul Agarwal: Why you do not follow a policy of booking the sales at Rs.49 only since for the entire year we have this cover?

Sandeep Arora: As per the standard and for the customs rate, you have to follow the current rate that you book at. So, that is what it is and it is not one-to-one that in an IT where you have a contract of the 100 million and against that same 100 million you take a cover. So, these are not one-to-one covers it is a basket.

Rahul Agarwal: Can you also provide some inputs on how you are looking at the energy cost and other raw material costs going forward?

Vijay Shah: Our energy cost has two parts; one is the electricity and the other is the natural gas. All our natural gas contracts are in Dollars and electricity contracts of course are in Rupee. The split is 40% may be electricity, 60% may be natural gas from my energy cost. Now, since the last hefty increase, which happened in the last few months of the last financial year, the last two quarters have been relatively stable on the actual energy costs except to the extent of the fluctuation in Dollar. So, I have been talking to some experts, the feeling on natural gas is that it has peaked. That means they are saying that because of the US producing so much gas and becoming self-sufficient and of course Japan thing is absorbed in the market, now whatever gas they were consuming, in fact as going forward they could be consuming lesser. With this scenario the feeling is that the price increase on LNG has peaked and because of which the prices globally will not go up in fact it could come down. That is our view on energy. Raw material has been more or less stable for the last two quarters. Again it has gone up towards the end of last financial year and that cost increase that came in, has not been passed through fully because some of the markets which are more domestic related like the pharma market and the others we have not taken price increase because of the domestic oversupply. So we have not been able to pass through this cost increase which happens at last quarter of the last financial year but these two quarters we have seen very stable scenario on the raw material prices.

Rahul Agarwal: During first half FY'13, we have not been able to drop down your borrowings towards the target that you plan to achieve of one is to one?

Vijay Shah: Agreed, there are two parts again to it, one is mark-to-market to that extent I think 50 or 60 Crores.

Sandeep Arora: The whole half year it has increased by 80 Crores out of which 30 is the mark-to-market and 50 is in this, of this 50, we have paid out dividend that is about 30-35 Crores including the taxes and when you really add a new furnace that takes its own working capital to the extent of its debtors and its inventory turns that it has.

Vijay Shah: In addition to cash generation, I think it went into working capital even with the addition of the new furnace which was capitalized in April and the dividend payout so that is where the cash flows went.

Sandeep Arora: The real usage is 50 Crores out of 80 that you see as an increase.

Rahul Arora: So, do we see our debts going down during the second half?

Sandip Arora: It should, if you see there is one time dividend payout which is not going to happen in the next quarter or the next half. So, to that extent if I remove those 30-35 Crores out of that 50 even if everything remains the same.

Vijay Shah: So, that is not there and I think there no major capex's in the future foreseeable future and again working capital also it is in line it should come down. Hopefully all this should help us. I see the debt also has a peak.

Rahul Agarwal: So, you do not see increase in working capital going forward?

Vijay Shah: No.

Rahul Agarwal: One question, again on your cover that you take on Dollar - Rupee, so do you plan to have such cover to future also, let us say for FY'14?

Vijay Shah: We have discussed this with the Audit Committee the Board and the guideline that they have given is that out of the net foreign exposure, we could cover half of that if we want to; however, what we have done is that quarter of that, we have covered selectively in the sense where we got rate in the region of Rs.60. Because one approach would have been to leave it open, the other is that where we got a clear against 49 or 59 to 60 so clear advantage of Rs.10 to Rs.11 is the only when we are covered to some extent.

Rahul Agarwal: Your Sri Lanka operations, there also have come out with the results so can you please throw some light on what has been the breakup of exports versus domestic?

Vijay Shah: Sri Lanka since it is a public company, the results at public domain. So, while Sandeep is opening that particular performance result, I must say that Sri Lanka has been doing very well in spite of, when I talk about cost increase in last quarter previous year Sri Lanka had a huge energy cost in **(indiscernible) 25.37** but they have been able to absorb that and come out of very good numbers so I think Sri Lanka EBITDA is again back to 35%. The exports may have been slightly impacted because they used to supply to United Spirits in India against the LC of course, but that has slightly, because of the conditions that that company is going through they must have a slowdown.

Sandip Arora: It is about 25-75 or 24 to be precise in H1 when compared to last year it is almost flat because of this slow pick up.

Rahul Agarwal: What is the capacity utilization you are having in Srilanka?

Vijay Shah: This question comes up again and again. Glass is continuous process industry. At any point of time, we have to utilize capacity fully. If we do not then we start bleeding immediately. So, ideally our glass companies somehow try and make something. If you notice the way for us to improve profits, so when I keep telling you that in Jambusar, we have a new furnace, which started in April. From the moment it starts producing as we stabilize, we will have to be utilize all the eight lines in the furnace so we are utilizing that today; however, if the market for which it has been built is not ready to absorb it we have no option but to go and supply in the local or "filler market". That is what currently we are doing for this new furnace and in this filler market because there is excess capacity in India, we are now getting the prices that we would have expected to get. So, coming to answer your question capacity utilization we have full, product mix is not optimal and there is lot of room for correcting that in the future.

Rahul Agarwal: So, you are saying even at 35% EBITDA margin the product mix to Sri Lanka is still not optimal you would like to enhance it further?

Vijay Shah: So Sri Lanka there is still room to meet the profits.

Rahul Agarwal: But what can be the saturation level?

Vijay Shah: Actually, that is what we do. Year-on-year we somehow manage 10% to 12% growth with the same capacity because we come up with ideas of optimizing, drill improvement, efficiency improvement, higher value product mix prices in Sri Lanka we started doing something different. We said okay how do you improve this further? So, we import perfume bottle in to Sri Lanka. They do not make that because India is better at it and they user the capacity if they get higher realization. So, as we go forward we will keep doing this so they will go for higher yielding export market and the lower yielding products they may even import not from us but form other companies in India.

Rahul Agarwal: What you are doing you are importing perfume bottle to Sri Lanka?

Vijay Shah: That is because in making in Sri Lanka they would not get sufficient yield. The cost is higher to maintain than compared to India. So that is one idea. The other for instance, as they go forward and they have higher yielding market because Sri Lanka can make very good high end bottles so like Antiquity all these bottles are the vine bottles for the Indian industry are made by Sri Lanka.

So, as they grow in the market they also start exporting to Australia. As they grow this market what they would do is they will barter buy having the low profitable products imported.

Rahul Agarwal: They will trade in that?

Vijay Shah: Yes exactly.

Moderator: Thank you. The next question is from the line of Prashant Kutty from Emkay Global. Please go ahead.

Prashant Kutty: Just wanted to know when do we expect the new capacity to achieve higher stabilization levels and the product mix to improve?

Vijay Shah: Between last quarter and this quarter the yield of the furnace has moved up from 54% to 74%. It has scope to go further in the range of 85% to 90%. Each line will have slightly different yields because based on how large is the job being run. So, that is one. Two is that is the internal issue. That is productivity or yield issue. I feel that next two quarters to gradually climb up. Definitely, the furnace profitability is not where we would have expected to be because this furnace was built to cater to the mass market and initially it would also have excess capacity available, which we are utilizing from the filler market. That is the local liquor and beer market. The point is that because of the pressures on the prices of local market, our competitors are even shutting lines, so bearish is the local market or there is excess capacity. We are not shutting any lines, we are running all the lines; however, we are not getting the price that we want. So, I assume that we are now starting to look at international food market, miniature markets to exploring newer market to improve the product mix of this furnace. So, this is going through a similar cycle, whenever we have new furnace I have noticed it goes though the problem of lumpy addition to capacity and linear growth of the relevant market. So today we have got a lot of sub optimal product mix, which we would do away with as we go into the future. So, it will keep improving quarter-on-quarter on this.

Prashant Kutty: As far as the premium segment is concerned, we just said that we have been facing pressure in the US market. How has it been in the European markets?

Vijay Shah: US market in the premium segment has not grown since several quarters. I would put it. Because the customer base remains the same and the product is not grown too much there, whereas we are gaining share in particularly in Europe market. So, that is why when you put the two numbers together when you look at the two separate numbers, India has grown at 30% in the premium market US has grown flat almost. So, on an average we are showing 17% to 18% growth.

Prashant Kutty: The reason why I am asking is what is the strategy going forward over here because we are saying that US has been flat for quite sometime now and we have been seeing moderation coming in the premium segment, the last quarter we saw 20% growth. Now it has come down to 15%?

Vijay Shah: When I say US is flat, I am referring to US production for the cosmetic and perfumery market. India is producing for the Europe market primarily and to the some extent for the US markets. There we have been growing quarter-on-quarter and I see no saturation point for this because as I kept saying in the earlier calls, we are hardly 5% of the global market. So, we got lot of room for growth in this segment. Even in the recession during the last time we kept growing in a premium market though the market overall had shrunk for some 10% to 20%. So, the same scenario is now, the market may be under pressure or in moderation but we are not impacted because we are growing in that market. For instance, we sell CK-1 to Kutty, and the entire CK-1 volume growth comes from us. Now if the global scenario is slightly weak, we will get slightly less orders for CK-1 but that does not stop us from continuing to add new products to our portfolio which we are doing gradually.

Prashant Kutty: Just one question on as far as the revenues are concerned out of this how much is the growth actually coming from the new capacity in our revenue number?

Vijay Shah: I can give you assured number of sales from this furnace, will that help you get that number? So let us say 23 Crores out of the total topline would be from the new furnace.

Prashant Kutty: That is for Q2?

Vijay Shah: It is for H1. The balance is same old capacity.

Prashant Kutty: Otherwise we have seen the mass market also growing by about 28% on a YOY basis over here, which has probably been a pretty much lower moderating to the last two three quarters, but this quarter we have seen fairly good amount of growth. So has it been that the Brazil market or probably the Turkey market have started doing?

Vijay Shah: I would not say that. I think as the capacity got available, we encourage people. So the 160 tonne furnace was primarily meant to get into the mass market. That is the reason it is. It is not that market has bailed out is linked to our more capacity being available to us.

Prashant Kutty: We continue to maintain our value growth guidance rate at about 20%-25% for FY'13 as of now?

Vijay Shah: I think we are achieving that.

Moderator: Thank you. Next question is from the line of Pritesh Chheda from Emkay Global. Please go ahead.

Pritesh Chheda: Just couple of question one on the realigned capacity if I recall properly couple of quarters there was some of the line adjustments, which were supposed to happen and had that first of all happened? My second question is have the realignments of most of the furnaces been through or if any one is planned? Third in this quarter all the furnaces were up in running or did we have any of the capacity which would be available in near future?

Vijay Shah: I recall last August was our Amber furnace which increased to 230 to 255 TPD, I am referring to August 2011, and then the April 2012, we started a new furnaces about 160 TPD, in May - June we realigned 65 TPD which went up to 95 TPD. This quarter 65 to 95 tonne furnaces was not available for 10 days. Other than all our furnaces were up and running this quarter. There is no realignment in the foreseeable future till next year also.

Pritesh Chheda: Basically, next four quarters at least there is not a case where any furnace would actually go for realignment and if any of it goes then which one it would be?

Vijay Shah: None of the furnaces are closer to the end of the life.

Pritesh Chheda: My question was in the new capacity that we had put up we had some synchronization of lines to happen which was slightly troublesome. I wondering has that probably got cleared of?

Vijay Shah: If you recall the last quarter a new capacity 160 tonne I said is not stabilized. This quarter that has improved from 54% yield in the last quarter to 74% yield in this quarter. So it is moving up and as I said it has got a scope for further correction to 85% to 90%.

Pritesh Chheda: In your domestic capacity which you have today in India in the two locations, which you have mentioned in the presentation. At what level you should be drawing in those capacities and at what level can you take it up and how soon and will it mean that there would be and corresponding overheads increase on account of that or the overheads should remain typically flat?

Vijay Shah: So, let me answer last question first. When we start a new furnace overheads all get incurred. So, it is a very flat overhead industry. So, the operating leverage does kick in the moment you increase sales. So, like 160 TPD whether the capacity goes up or not the overheads are already in place whether its energy, fuel, electricity and manpower. Your other question was that in India the capacity that are there so as I keep telling the drawing is fully we have no option but to draw as close as possible to 90% to 110%.

Pritesh Chheda: So, the product mix is where it gets skewed? Now these two areas - what it is today and what kind of improvement one can see over the next four quarters?

Vijay Shah: You got six furnaces in Kosamba and three furnaces in Jambusar and nine furnaces we do not have common denominator. What I can tell you that the in the all the existing furnaces like you see in Srilanka which was one furnace, Srilanka is year-on-year, quarter-on-quarter tweaking. Tweaking is yield, tweaking is draw, tweaking its product mix, to improve the profitability. So that continues to happen on all the nine except one furnace, the 8 furnaces the one new furnace we have lot more area to cover. So the product mix improvement is the journey that we have to chase as we go along because premium the entire one location Kosamba, we would like to make it a premium location. So, there is lot more room for us to grow there and if you recall that we were pushing on mass and so that not to push out mass, we had started the new furnaces in

Jambusar, the 160 TPD, so that is were we have created capacity for mass plus some additional capacity. So there is a lot of room for growth.

Moderator: Thank you. As there were no further questions, I would now like to hand over the floor back to Mr. Sandeep Arora for closing comments.

Sandip Arora: Thank you for your questions. Wish you all the vey best for this festive season.

Vijay Shah: I would also like to add that this is the phase we are going through and you will have to have some patience. If you notice that in the past also we have bounced back through turbulent times. This performance is not as bad as what we used to have in the past. I feel that we will soon be able to bounce back, overcome the issues on exchange rate and I think this company has a great future. So bear with us for through these times and wish you all the best and Happy Diwali. Thank you.

Moderator: Thank you. On behalf of Piramal Glass Limited that concludes this conference. Thank you for joining us.