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Essel Propack

Q1FY16 Conference Call Transcript

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Moderator:

Ladies and gentlemen, good day and welcome to the Essel Propack Q1 FY2016 Earnings Conference Call, hosted by Emkay Global Financial Services Limited. Today, we have with us Mr. Ashok Goel, Vice Chairman and Managing Director; Mr. A.V. Ganapathy, Mr. Roy Joseph, Regional Vice President for AMESA; Mr. Vinay Mokashi, Financial Controller; Mr. Amit Jain, Head of Treasury; Mr. Ashok Vashisht, Regional Financial Controller AMESA. As a reminder all participant lines' will be in the listen only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Prashant Kutty from Emkay Global Financial Services. Thank you and over to you Sir!

Prashant Kutty:

Good Afternoon everybody. Thank you for joining us today. We would like to welcome the management of Essel Propack and thank them for giving us the opportunity to host this call. I would now like to handover the call to Mr. Ashok Goel for his opening remarks. Over to you Sir!

Ashok Goel:

Thank you Prashant. Good afternoon ladies and gentlemen. It has been a good start for us this financial year with global operation posting net profit of Rs.38.4 Crores, on a revenue of 575 Crores during the first quarter ended June 2015. Compared to the same period last year the net profit has grown by 45.7% and revenue has grown by 4.7%. The non-oral care category share in consolidated sales for the quarter is 43.3% compared to 42.2%, which is a favorable improvement of 1.1%.

EBITDA margin for the quarter is 18.1% as compared to 16.1% same period last year; therefore the improvement on EBITDA margin is 2%. The first quarter for us is normally muted. All the same, the quarter's EBITDA margin has improved sequentially by 70 basis points helped by improved product mix globally. This month we divested our flexible packaging subsidiary Packaging India Pvt Ltd. The financials are normally consolidated at AMESA region level. However, the impact of this transaction will be reflected from subsequent period.

As for the regions , all of them have turned out good performance compared to previous year. If I start with Europe, Europe has grown by 19%, but if we exclude the impact of weakening Euro then the actual growth in Europe has been at 38% and improvement in margin by 3.3% points. It is matter of satisfaction that our strategy for East Asia Pacific that is China headquartered is beginning to bear results. During the quarter, EAP region sales grew by 16.8%, but because there is an appreciation in the local currency the underlying growth is 9%, helped by 42% growth in non-oral care category and consequently the operating margin improved by 4% points.

The non-oral care share in East Asia Pacific sales, which was at 22.5% for the financial year 2015, now stands at 31% showing an improvement of 8.5% in the first quarter. Americas continue to focus on non-oral care category. The transition from plastic tubes to laminated tubes solutions in the US and the rapid ramp up of capacity in Colombia have helped the operating margin to improve by 1.8% points. In AMESA that is Africa, Middle East & South Asia headquartered in India, Egypt continues to expand in the non-oral care category. With several new contracts under implementation. In fact this quarter our global revenue excluding India has grown by 12% over the previous year and if we exclude the impact of the currencies the underlying growth is 13.5% over the previous year.

The divested flexible packaging business, which is a part of AMESA; however, posted a sales de-growth of 16.7%. The India tubing sales, even though has grown both in value terms and volume terms, but because of the raw materiel price adjustments the impact of the growth has been negated. Therefore, it shows a muted growth. So we are focusing on creating new opportunities by offering innovative solutions in the food and pharma categories. As the economy and the FMCG demand recovers, we expect India operations to get back to the growth trajectory; however, the raw material adjustments again may impact, but even after that we except the growth in India to come in the subsequent quarters. Sustained and strong operational performance over the last 11 quarters continues to improve the cash flows and the balance sheet. The return on capital employed is improved to 17% from 16% last year and return on equity has improved to 19.5% as against 18.9% on trailing 12-month basis. Working capital continues to be a focus area where we see an opportunity to improve or to reduce the working capital. The divestment of the flexible packaging business will further improve the finances and help us pursue growth opportunity in the core business. With the robust strategy and commitment to execution we continue to be on track to achieve our stated objectives. So with those opening remarks, I would now open the floor for questions please.

Moderator:

Thank you very much. We will now begin the question and answer session. Our first question is from the line of Niraj Mansingka from Edelweiss. Please go ahead.

Question and Answer Session

Niraj Mansingka:

Congratulations for the good performance. I think there has been quite visible performance improvement. Sir few questions - one is on the China side. Can you give more colour on China what you are doing and how do you see this scale up the new contracts and can you also give some colour on margins in the china EAP segment?

Ashok Goel:

Thank you, Neeraj. In East Asia Pacific, China particularly the non-oral care growth has been good, which means that the newly opened facility we call EPSL in South East of China has started to yield results even though not fully ramped up . This is evident from the growth in non-oral care at 42% and shifting of the revenue share from 22.5% to 31% demonstrates that we are on the right track. The new contracts that you are talking about is probably on the oral care side, which has already started and we have commenced the supplies; even though it may not be at a full scale as has been contracted in the first quarter. EAP also consists of Philippines and we are seeing Philippines also exceeding their targets. Overall we see the growth momentum in China continuing particularly in non-oral care. Even though the overall oral care demand in China is muted, but since we have got the new contract from oral care category therefore we do not expect any de-growth in oral care to happen. It is now for us to gain the market share and sell more non-oral care tubes, which is on track.

Niraj Mansingka:

Sir, when you are talking of non-oral care category you are referring to Suzhou capacity which is in operation - right?

Ashok Goel:

Suzhou and we also have in Guanzhou

Niraj Mansingka:

Yes Sir, but how you see the revenue growth like any thought process how the revenue of the non-oral care category can grow from here, visibility on that?

Ashok Goel:

Underlying growth is 9% Niraj which is by and large coming from non-oral care and we expect that growth to continue and the indication so far is that we will continue to grow. The only thing that we need to watch out for China, and that is for anybody dealing in China, is the impact of the stock market melt down; whether it is going to have any impact in the local consumption in China is something for us to see, but if at all that impact comes it should be visible from third quarter onwards not the second quarter.

Niraj Mansingka:

Sir, how much is the capacity utilization of the Suzhou facility right now?

Ashok Goel:

We are using about 50% or less ; therefore we have the headspace for growth also.

Niraj Mansingka:

Right, another question is on the India COCO model. Can you also share some thought process what happened on the COCO model and will we scale up and by how much?

Ashok Goel:

COCO model is growing nicely Niraj. Although the India sales numbers show muted growth - does not show that exactly as the accounting is not the same way as of tubes we sell normally. , I cannot give specific number because it is pertaining to a particular customer; that would tantamount to sharing the confidential information, but it is growing and can we expect it to continue to grow. In fact there has been more capacity added and so have we added additional people in that facility; so to that extent our people cost has grown and it is an indication we have from the customer it is going to grow nicely.

Niraj Mansingka:

Sir, any more colour on India's demand in the oral side?

Roy Joseph:

Niraj, we are seeing some growth coming back as far as oral care concerned. We are also gaining share in the oral care business because we won some new contracts last year ; as we explained the volumes are kicking in this year . So for us at Essel we are seeing benefit of growth in the oral-care category.

Niraj Mansingka:

Just a relative discussion, how much was demand for Q1 in the oral side as revenue growth?

Ashok Goel:

Revenue growth this quarter was actually skewed towards oral care. Last year the same period, our oral care share was 47.9% which has actually gone up to 49.7%. So therefore the sales in oral care have been higher than in the last year.

Niraj Mansingka:

I have more questions, but I will come back on the queue. Thank you.

Moderator:

Thank you. The next question is from the line of Dixit Mittal from Subhkam Ventures. Please go ahead.

Dixit Mittal:

Good afternoon Sir. Sir, in Europe you mentioned that because of cross currency, you lost around 13 % of sales, so what was impact on margin Sir?

Ashok Goel:

Let us understand that in context, Mittal. There was no loss; it is only a translation difference. There is no loss or gain because we do the business in a particular currency, when we report in Indian rupees, the exchange rate in translation gets impacted. So, there is no real gain or loss, but overall, Europe has gained margin by 3.3%.

Dixit Mittal:

Okay, but Sir, if you see sequentially for the last three quarters, so we have been in the range of 90 Crores revenues and around 5% to 6% kind of EBIT margins. So Sir, do you see the run rate on sales as the margins improving going forward?

Ashok Goel:

Yes, it will continue to grow as we see.

Dixit Mittal:

Sir, I am saying in every region like if you see after Q1, Q2, Q3, Q4 and this year's Q1, so we have been flat in terms of revenues as well as profitability in all the regions, so are we growing in terms of volumes or what is happening?

Ganesh Ganpathy:

First let us note that this quarter always is a little bit muted. If you are looking at EBIT margin, it also reflects this, correct?

Dixit Mittal:

Right.

Ganesh Ganpathy:

The best way for you to compare is with the last year. If you see across all the regions, my operating margin has improved.

Dixit Mittal:

So you mean to say that the kind of margin improvement you have seen YOY, so that will result into next year's YOY as well, second quarters YOY?

Ganesh Ganpathy:

Exactly, so that benefit will continue to flow through, right. There could be little bit of a price pass through etc. there could be little bit of a lag/lead impacts will as a normal business, but the shift you are seeing in the margin is indicative of an improvement happening across the regions.

Dixit Mittal:

Okay. Sir, in AMESA region, what was the impact of de-growth in flexible packaging if you can in terms of Crores, just can you give some idea?

Ashok Goel:

Well that we have divested . While Ganesh figures out the numbers, the reason for de-growth was simply because we were in the process of making this deal. So, obviously operating team did get defocused. That was the reason why de-growth happened.

Dixit Mittal:

Sir, excluding that, how much growth have we posted excluding the flexible packaging?

Ganesh Ganpathy:

Excluding the flexible packaging? What are you asking?

Dixit Mittal:

What is the growth Sir?

Ganesh Ganpathy:

The topline growth is 2.2% for the region.

Dixit Mittal:

2.2 % positive. Sir, finally in China, the reported growth is 17% and you mentioned that because of currency, you lost some percent, so what was that figure?

Ashok Goel:

Underlying growth is 9%.

Dixit Mittal:

Underlying is 9%, but reported is 16.8%.

Ganesh Ganpathy:

Correct it is again a translation impact.

Dixit Mittal:

Yes, so Sir, in China also we are seeing 140 Crores kind of revenues for the last four quarters, so do you expect the run rate to inch up from next quarter onwards.

Ganesh Ganpathy:

Again please compare year over year and also, let us not forget, there is a seasonality in our business as well.

Ashok Goel:

So, if you take a constant number and compare it with three quarters, it may not be the right way.

Dixit Mittal:

Okay, so 9 to 10% growth, you will be maintaining from Q2 onwards as well.

Ashok Goel:

That is right.

Dixit Mittal:

Thank you Sir.

Moderator:

Thank you. The next question is from the line of Niraj Somaiya from Span Capital. Please go ahead.

Niraj Somaiya:

Ashok and team. Congratulations on a good set of numbers. My first question would be on your packaging division, which you have sold. How much would be realized and how much working capital would be freed from this sale of assets?

Ashok Goel:

Good to hear your voice Niraj. The packaging India sales enterprise value was Rs.165 Crores, which means that some of the debt that was sitting in that balance sheet, which was getting consolidated, so effectively if you see that all 165 Crores, we will reduce our debt by that amount on opening balance basis.

Niraj Somaiya:

So, which is right now about Rs. 830 crores or what would be the current balance of debt?

Ashok K Goel:

That is June quarter closing is Rs. 916 Crores on a gross basis and Rs.800 Crores on net basis- that will go down again.

Niraj Somaiya:

That will be almost 150 Crores; you would further have a reduction in whichever way you call it basically working capital, it would reduce by about Rs.150 – Rs.175 Crores. Have I understood right?

Ashok Goel:

Absolutely, but not more than Rs.150 crores.

Niraj Somaiya:

That would be straight saving to you?

Ashok Goel:

Yes.

Niraj Somaiya:

Sir, that is one question and the second question would be that you have done phenomenally well this quarter and you also mentioned in your annual report, that in the next five years, you see 15% to 20% growth. With this quarter being satisfied, do you think that will continue? you see that 15 to 20% growth for few years to come?

Ashok Goel:

It is great point Niraj, so on the underlying basis, we are still saying 15% growth will come; however, there are caveats. Caveat number 1 is that flexible packaging business having gone now, is going to reduce my topline by Rs. 250 Crores on an annualized basis, this year because it is first quarter revenue we still have included their number; so to that extent, we need to make up, that is number 1. Number 2, because of the raw material pass through and therefore pricing coming down, the percentage in terms of revenue may not show up 15%, so adjusting for these two caveats, underlying growth 15%, we still maintain we will grow.

Niraj Somaiya:

ROCE?

Ashok Goel:

Of course bottom line growth 20%, we stick to it, ROCE target of 20%, we stick to it, which is actually 17% and ROE is 19.5%.

Niraj Somaiya:

My third question would be on the Pharma business, anymore progresses and how have you been getting on with that and that is one another very large segment which the company could add in the next few years. What are the initiatives you have taken, any improvements, or any more focus there, could you just throw some light on the Pharma side of it.

Ashok Goel:

Yes, good point again. In Pharma our business on the underlying basis again is grown, which means that we have added more customers; however, with some customers, we have not lost the share but volumes have reduced because their export sales has come down primarily because the currencies of some of the countries to which they export have devalued disproportionately. As a result, they are not able to export in this particular quarter and we expect the situation to correct for next quarter and therefore pharma growth is continuing.

Niraj Somaiya:

But in the next five years, can it be 20 % of your business, I mean because it is a very high margin business or do you think that is a very aggressive number in the long term basis do you think the company could have that sight of size in the pharma business itself?

Ashok Goel:

So let us understand - the opportunity itself is 10 billion tubes globally and if you remember, our strategy for pharma is, we are going from downhill to uphill, which means that first venture into the emerging markets and go to the developed markets and whereas in beauty and cosmetics, we are coming from uphill to downhill, that is from developed market to emerging market. Therefore, even though the efforts in all geographies for these categories continues, the growth that we expect in pharma is to come from emerging markets. We have not calculated, will it be 20% or not on a global consolidated basis, but yes, it will form a significant part.

Niraj Somaiya:

Sir, the last question is which we discussed earlier also, any employee stock options that is the company was working on, any more light on that and on any dividend payout ratio, anything fixed on that?

Ashok Goel:

Yes, as to employee stock option, as shareholders have already approved that scheme , we have launched that scheme, which is of course going to a certain level of employees globally. The scheme runs for next three years in terms of vesting and of course, people can exercise their options depending on the conditions of scheme for subsequent three years or so. The stock option, let me clarify, the promoters and directors are not entitled for the scheme. On dividend, we already have stated our dividend policy, that it will range between 20% and 25% of global profits, and we will continue to do so.

Niraj Somaiya:

My last question would be on China, how big is China now currently and how damaging can it be, because I am just to understand, and I am sure, you are the corporate also would be looking at, how big it will be right now of your business of your total turnover?

Ashok Goel:

China as of now is 22% including Flexible packaging and 24% of revenue excluding Flexible Packaging.

Niraj Somaiya:

Bottomline wise, it will be much lower right?

Ashok Goel:

Bottom line wise, in terms of EBIT is 26%.

Niraj Somaiya:

No, I mean, that if China gets affected, does the company get significantly affected or that is what my question was, so how much is the impact if you see in the 3rd, 4th, 5th and may be next year, China is slowing down or something, does this have?

Ashok Goel:

Yes, so there are lot of ifs and buts, should that happen, what will be the impact? So, let us say, oral care will be intact, because it is a daily use item, it has a high penetration; in fact the brand owners are making more efforts to get even higher penetration of oral care, promoting brushing teeth twice a day , not just once, premiumization of toothpaste etc., all that has been going on and because it is a daily use item, we do not see much impact there from the current level. The growth can be a question mark, but from the current level, and even in the non-oral care, if you see the volume that we are doing is not so much, it is only the value, which is actually good, which is not a bad thing in the sense that there is so much market still out there for us to convert to laminated tubes. Therefore, even if the consumer sentiments was to go down a little bit, I do not think it should impact us on the existing business. What may come under question is, how much will we grow and that is something we still have to wait and see.

Niraj Somaiya:

My last question will be on the capex equal to depreciation that would continue for the next one or two years in terms of the management strategy or now with such good growth, would you relocate that statement?

Ashok Goel:

No, you are right, Our strategy continues to be the same, that our capex will be same as depreciation. This year depreciation is expected to be about 160 Crores and of course, we always qualify that by saying strategic investment is not counted into this; because we have divested the flexible packaging business, annual revenue of which was Rs. 250 Crores, we will try and figure out as to how we recoup that and yet grow by 15% on the underlying basis, so that is something that we are working on and that is something that may come up. That is the only detail I can give right now. Thank you so much Niraj.

Niraj Somaiya:

Thank you so much sir, have a great year ahead.

Moderator:

Thank you. Next question is from the line of Andrey Purushottam from Cogito Advisors. Please go ahead.

Andrey Purushottam:

Your share of non-oral care has grown very marginally year-on-year. Internally, are you satisfied with that or would you like the non-oral care percentage to be higher?

Ashok Goel:

Of course, we would have liked it to be higher. We always have said that non-oral care target is always a moving target- , why because we continue to look for growth in oral care as well, so in case of India, it has actually moved the other way round for this quarter. So, to that extent, these movements will continue to happen. For example, in Europe, we desperately wanted oral care, because we were almost 90% in non-oral care and for us to get the economy of scale, we wanted the oral care, which has come in and we are supplying and therefore the ratio is again is changing because of that. So while we are cognizant of the fact that we want to take the non-oral care share to 50% and our efforts are in that direction in almost every geography, but some bit of shift here and there will always happen because it is a moving target.

Andrey Purushottam:

The other thing was that you know you have guided 15% topline growth in the next two years and 20% bottomline growth, so given that this quarter's results we have 4% increase in revenue and 40 plus increase in profit, and of course, these factor is not easily replicable, but I was just wondering whether the bottom line guidance's are little too conservative?

Ashok Goel:

First of all, it is same period last year and so first thing is that first quarter is always muted in our case. The second thing is that the first quarter of last year was extraordinarily soft for us. Therefore this growth looks little higher and number 3 - bottom line that we will restrict to 20 %, but that is not just for one year, we are saying 20% growth for the next five years.

Andrey Purushottam:

That I appreciate, I am just saying that your profit growth is likely to be much faster than your revenue growth, you only will be given a 5% differential between that and given by your recent past records, I would have thought that various things such as leverage would kick in and your profit growth should actually be much higher than the margin by which your profit growth is higher than your revenue growth, should be more than 5% over the next four to five years is what I would have surmised?

Ashok Goel:

Yes, you are right, I am just looking into the numbers so far that what you are saying is absolutely correct, but we always have to execute things and we see some geography or the other always going soft or hard or whatever, so some bit of balancing, we try to do and try to make sure that we are not over committing to you.

Andrey Purushottam:

Could you just share some of the marquee clients you have added in Q1 in non-oral care globally?

Ashok Goel:

Marquee clients we have added in non-oral care globally? Unilever is one, Proctor and Gamble is other one, L'Oreal is another one, Oriflame is one, different geographies, again these are all global customers, there would be regional marquee customers as well.

Andrey Purushottam:

Thank you.

Moderator:

Thank you. The next question is from the line of Chintan Seth from SKS Capital. Please go ahead.

Chintan Seth:

Thanks for taking my question. Just, you explained about the China in detail, I just wanted to understand you mentioned about the new facility is not fully ramped up, so what kind of revenue growth over the next few years with the new facility kicking in, will add to the topline, would like, annual you are doing around 500 odd Crores annually at EAP region, so what additional benefit or additional revenue, a ballpark figure can help me out?

Ashok Goel:

In China, when we said that the new facility is not fully ramped up, which is in fact was part of the plan, so obviously we currently are using only 50% of its capability ; but then I cannot link the growth in subsequent years because you are assuming that we will remain constant in terms of capacity and capability. If they are able to develop more business, we obviously require more capacity. So just linking to current capacity or capability in China does not restrict me for growth beyond the current capabilities. So therefore our objective always is to keep growing and global average growth expectation of close to 15%, some geography will be less, some geography will be more.

Chintan Seth:

Right, and in India you did mention that business did not grow in terms of mix basically because of the pharma, one of the clients faces some problem related to exports. How quickly it can ramp up in terms of subsequent quarters? What is your take basically? How do the new clients coming in oral care in India?

Ashok Goel:

Chintan, in non-oral care, let us first understand the macroeconomic situation in India. The macroeconomic scenario, if you guys might have come across the AC Neilson report on FMCG, we have just seen a significant drop in new launches from 2013 ; if it was 17000 new launches, it has now dropped to 10500. So, that is reflective of the macroeconomic situation and therefore we hope that the Indian economy starts to settle down and we can also grow. In terms of pharma particularly that you are asking, we believe that in the next quarter i.e. the second quarter the numbers should start to come back again, because we have won some new business as well, which will compensate for at least some the lost business.

Chintan Seth:

Thanks and all the best Sir.

Moderator:

Thank you. Our next question is from the line of Ritwik Sheth from Span Capital. Please go ahead.

Ritwik Sheth:

Good afternoon and congratulations on a great set of numbers. Sir, a few questions. Firstly on the flexible packaging, we will have 10% of the revenues going out in this financial year so as I understand margins are sub 10% EBITDA margins. So what will be the effect on the consolidated margins, will it increase by 100-basis points?

Ashok Goel:

Yes it will.

Ritwik Sheth:

By 100-basis points?

Ashok Goel:

Yes on a consolidated basis about 1.1pp, yes.

Ritwik Sheth:

We have already like paid out the 160 Crores to 170 Crores of debt and it will be reflective from Q2, is that understanding right?

Ashok Goel:

Rs. 165 Crores, not 170 Crores. It could be 170 Crores because we would have paid some loan anyways out of our cash flows. So Rs.165 Crores on an opening level basis of the quarter.

Ritwik Sheth:

So in that way it will kick in like 10 to 12 Crores of internal additions?

Ashok Goel:

10 Crores free cash, yes.

Ritwik Sheth:

Free cash, right. Continuing on the previous pharma and beauty questions currently what would be the pharma proportion from the non-oral care? Can you give that break?

Ashok Goel:

Sorry we do not have that breakup.

Ritwik Sheth:

So, where I was getting at like do you have any sense on the penetration level of laminated tubes in the pharma segment currently?

Ashok Goel:

Unfortunately, I have to keep saying that we are just scratching the surface and any attempts for us to start measuring in the market share of which category of non-oral care, which subcategory of non-oral care is a little premature for us.

Ritwik Sheth:

Sir, in this quarter we have seen all the segments, all the geographical segments have reported a better EBITDA margins like some 100-basis points in Americas to almost 300 to 350 basis points in Europe and China. So are these margins level sustainable?

Ashok Goel:

Absolutely Ritwik, because what can get in the way, let us understand that. What can get in the way is that for example the price reduction because of raw material, which we have already passed on majority of it. If further goes down, then yes, but the margin as a percentage keeps improving, so I keep losing in terms of revenue growth but in terms of margin I keep growing. So those are certain dynamics and that is one of the question. Andrey asked previously is another dynamic that because of the raw material price movements, the revenue movements also happen, which may or may not track on to the 15% revenue growth target, but on underlying basis, we would still be growing.

Ritwik Sheth:

Sir, you mentioned on the standalone, the domestic oral care was higher this quarter due to some reason. Sir, can you explain like we have seen 250 basis point improvement on the standalone despite oral care being higher. So, is that primarily because of the decrease in raw material prices?

Ashok Goel:

Decrease of raw material we would have passed on already. So, in fact we have passed on because the growth therefore is showing not a drop, but flattish ; if that was not the case, then the growth in India tube business would have been up by 4%.

Ritwik Sheth:

My final question is on Europe - like last one to one and a half years, four to six quarters you have seen a negative PAT into positive PAT and currently we are at 5% to 5.5% on EBIT level so going forward next one year or two years, what EBIT margins would you aspire to reach, can we reach double-digit as the rest of the geographies?

Ashok Goel:

Ritwik, good point, and as I have been answering even in the previous calls, as our economies of scale gets better that means more we improve business , which is why I have said even in the last call that we are hungry for growth in Europe, 1) we are able to grow anyways, 2) we are even hungrier because we want to reach to a certain economy of scale so that Americas and Europe both can track the margin levels same as India and China. So therefore we will continue to do that. Therefore I say yes it is possible.

Ritwik Sheth:

That is it from my side. All the best. Thanks.

Moderator:

Thank you. The next question is from the line of Vaibhav Bid from Motilal Oswal. Please go ahead.

Vaibhav Bid:

What is your capacity utilization in the oral care division currently?

Ashok Goel:

Sorry I missed your question?

Vaibhav Bid:

Capacity utilization in the oral care segment?

Ashok Goel:

This question comes repeatedly. The capacity as of now I can say that that except for Mexico and some bit in India we do not have any overcapacity. Having said that we always keep at least 10% of headspace in every market that helps us to meet the spikes in the demand for the customers that we service; so theoretically it is available, but for all practical purposes it is not there. So we do have some capacity in Mexico. We do have little bit in India.

Vaibhav Bid:

But most of them are utilized, right? Only fair capacity for maybe some extra orders or something?

Ashok Goel:

That is right.

Vaibhav Bid:

Sir, getting a sense on the non-oral care, I mean, I am sure you all must be looking at the segment and saying okay, now our market size is, so is there anything that we are looking to target specifically in this?

Company Speaker:

You are talking non-oral care right?

Vaibhav Bid:

Yes, non-oral care.

Company Speaker:

So there are several categories in the non-oral care, which we have been explaining like beauty and cosmetics, pharmaceuticals, foods, even there are home applications where we are making headway. So ,these are huge numbers here and again it differs from region to region, geography to geography. Some regions are very strong in food in tubes, if we talk of Europe or of China, then there are also opportunities coming in terms of products traditionally packed in bottles which now are looking to convert into format like tubes, large diameter tubes, so the opportunity in this market has, as we had indicated, a global size of approximately about 12 billion tubes and what is available in pharmaceuticals and things coming in the aluminum packaging offer another 10 billion tube opportunity.

Vaibhav Bid:

That can be converted to.

Company Speaker:

This is still not considering the opportunity to convert from adjacent packaging categories. Tubes have a very big advantage over some of the other packaging forms and we are seeing that sort of a transition happening globally. Ashok was mentioning that at this point in time, we are actually entering into this. All the growth you are seeing is our entry, so we are not even to state in terms of what is the market share or anything here, it is a huge opportunity and we have the right products and we have the capability deployed globally to start making an impact here, in a sense we are leading this process.

Vaibhav Bid:

Sir going forward how much can we expect non-oral care to form for the entire business?

Company Speaker:

That is what we said and the question was answered when Andrey also raised the point. We have said in the next couple of years we are looking to reach around 50% of our sales coming from non-oral care

Vaibhav Bid:

And we are already ready for it, right Sir with the capacities?

Company Speaker:

We are now around 43.1%. As Ashok mentioned earlier also , this does not mean that we will stop all our business in oral care.

Vaibhav Bid:

That is going to be like a running business?

Company Speaker:

Yes, if I get some big contracts and therefore my oral care grows little sharply in a particular year, it might take a back step it does not mean that our efforts are not there and non-oral will continue to grow also as strongly.

Vaibhav Bid:

Sir, in terms of the capex Sir said that it will basically equal to the depreciation of around 160 Crores, right Sir.

Company Speaker:

Normal capex.

Vaibhav Bid:

So that would be used in expanding anything or just maintenance capex?

Ashok Goel:

Most of our capex is actually for expansion.

Vaibhav Bid:

Expansion for the?

Ashok Goel:

The normal demand growth because we do not keep huge idle capacity. It is a modular expansion that we follow.

Vaibhav Bid:

This will be basically for the machinery, right Sir?

Ashok Goel:

That is right, absolutely.

Vaibhav Bid:

Sir, just one more question on the non-oral care in India especially are you already got in touch with big clients and gotten orders?

Ashok Goel:

In India we are already a large player in the non-oral care. We have the largest customer base in India. Non-oral care is about 50.3% of our total sales.

Vaibhav Bid:

50.3%?

Ashok Goel:

In growth market we see much and much bigger opportunities here actually.

Vaibhav Bid:

In?

Ashok K Goel:

In India.

Vaibhav Bid:

In India. That is what I mean in India it is a huge, huge opportunity. Even if you compare globally, but India there is so much on the plate. Thanks a lot Sir.

Moderator:

Thank you. Our next question is from the line of Mithun Soni from Geecee Investments. Please go ahead.

Mithun Soni:

Congratulations on good numbers. Sir, just want to understand little simplified way, you said that we are targeting a 15% growth with some caveats on the raw material price being a pass through, right Sir?

Ashok Goel:

Yes.

Mithun Soni:

The revenue if I was to look at the gross profit because you said the gross margins will change if the raw material price comes down because as a pass through, so if I was to look at the gross profit per se and can I say that we would be targeting a 14% to 15% growth in the gross profit itself because topline and the raw material is nothing but just a pass through factor?

Ashok Goel:

Let us get the facts right, Soni .So, we had started out with the topline numbers. The topline caveat was one , because of the softening and assuming that the raw material price remains open then it may on the surface look that the topline growth is lower but underlying growth might still be 15%. So that is one thing, and also the divested business of flexible packaging will have an impact on the revenue growth numbers . So these were the two caveats that I had put.

Mithun Soni:

So basically my question is like as you rightly said now where does the raw material price goes we do not know so if I say purely revenue growth minus the raw material cost, which is the gross profit whatever way the movement happens above we would be trying to target at least a 15% growth in the gross profit.

Ashok Goel:

I am saying 20% in net profit, my friend. So therefore I was saying that the fact is not correct. Even if there is a price pass through which is the case, then my margins percentage will actually go up not go down.

Mithun Soni:

Agreed.

Ashok Goel:

So now that is the first fact getting right. I am saying I am targeting the PAT ,profit after tax growth of 20% not gross margin growth of 15%.

Mithun Soni:

Perfect. That is it from my side. Thanks.

Moderator:

Thank you. The next question is from the line of Niraj Mansingka from Edelweiss. Please go ahead.

Niraj Mansingka:

This is Niraj Mansingka this side. Sir, just I had a question on the debt plans on the company. You mentioned that your gross debt was Rs. 916 Crores as of end of Q1 right?

Ganesh Ganapathyl:

Yes.

Niraj Mansingka:

You were expecting 150 Crores reduction, which I am guessing would be from the proceeds of the divestment that you just made?

Ganesh Ganapathy:

That is right.

Niraj Mansingka:

Any other plans of reducing debt any further or we will be looking at debt of around approximately Rs.750 to 760 Crores at the end of FY 2016?

Ganesh Ganapathy:

There is also the normal reduction in the debt, which has been happening, if you see in the last couple of years from regular cash flows, with my cash flows we are dropping around Rs. 50 to 60 Crores a year so that also could be in addition to that. That is one part. What you suggest, Nihal should we become debt free? I think if you have to give value to shareholders we need to have debt, right?

Niraj Mansingka:

Absolutely Sir.

Ganesh Ganapathy:

So, if you see my debt equity ratio today is around 1.1; in terms of debt to EBITDA which all the rating agencies are looking at, we are now heading to what we were always aspiring to reach – around 2 which should take our rating to AA. And that will be a good situation to be in right.

Niraj Mansingka:

Definitely Sir. I just wanted to understand the plan. So, I am guessing that you are just looking at a 50 Crores to 60 Crores regular reduction post the 150 Crores?

Ganesh Ganapathy:

Yes.

Niraj Mansingka:

That answers my question. Thank you so much.

Moderator:

Thank you. Ladies and gentlemen that was the last question. I would now like to hand the conference over to Mr. Prashant Kutty for closing comments. Thank you and over to you Sir!

Prashant Kutty:

Thank you. Before we just close, I just have one question and just a clarification over here Sir. Just in regard to one of the participant's question, I guess the question I do not know if I can frame it correctly, but I guess the question over here was that typically when I am referring to that my revenue growth , these one offs if I am looking at a 15% revenue growth am I trying to mention that if I probably look at the cost of goods sold, which I am referring to, which is typically my raw material cost, so if I actually exclude my raw material cost from my sales, then which I am referring to is your gross profit number which is purely a gross margin or your gross profit which I am referring to would that also mean to actually about 15% growth. I guess that was the question, which he was referring to. Just to get a clarification on that?

Ashok Goel:

It may not be linked, Prashant, if you look it holistically.

Prashant Kutty:

Sir, just one last question in terms of gross margin numbers, if you look at this quarter's gross margin numbers it has been pretty strong over here. As you just highlighted that when you actually have a revenue cut, you actually see a margin profile to improve. Could I know what percentage of it would have been on account of mix improvement?

Ashok Goel:

That is a tough one, Prashant. With regard to product mix I think we will have to work it out.

Prashant Kutty:

Just one last question Sir, in terms of cost cutting at our end and probably trying to control cost over here, we believe we do have some more levers left in terms of cutting the cost side as well, right in few markets?

Ashok Goel:

Unfortunately, I cannot share that openly. That may have some consequence.

Prashant Kutty:

Thank you very much. On behalf of Emkay, I would once again like to thank you all for joining the call today. Sir, if you have any closing comments.

Ashok Goel:

Thank you. Greatly appreciate all of you joining in and in our investor's note, we have also given the global peers comparison. So please pay attention to that as well. Thank you so much.

Moderator:

Thank you very much Sir. Ladies and gentlemen on behalf of Emkay Global Financial Services Limited that concludes this conference. Thank you all for joining us. You may now disconnect your lines.

Note: 1.This document has been edited to improve readability.

Emkay Rating Distribution

BUY	Expected total return (%) (Stock price appreciation and dividend yield) of over 25% within the next 12-18 months.
ACCUMULATE	Expected total return (%) (Stock price appreciation and dividend yield) of over 10% within the next 12-18 months.
HOLD	Expected total return (%) (Stock price appreciation and dividend yield) of upto 10% within the next 12-18 months.
REDUCE	Expected total return (%) (Stock price depreciation) of upto (-) 10% within the next 12-18 months.
SELL	The stock is believed to underperform the broad market indices or its related universe within the next 12-18 months.

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