Ester Industries Limited

Q3 & 9M Earnings Conference Call
February 13, 2019

Moderator: Ladies and gentlemen good day and welcome to the Ester Industries Limited Q3 and 9M FY19 earnings conference call. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Gavin Desa from CDR India. Thank you and over to you sir.

Gavin Desa: Thank you. Good day everyone and a warm welcome to Ester Industries Q3 and 9M FY19 earnings call. We have with us today Mr. Arvind Singhania, the Chairman and Mr. Pradeep Kumar Rustagi, the Chief Financial Officer.

We will begin this call with opening remarks from the management following which we will have the floor open for interactive Q&A session. Before we begin, I would like to point out that some statements made in today's discussion maybe forward-looking in nature and a note to this effect has been sent in the con-call invite earlier. I would now request Mr. Singhania to make his opening remarks.

Arvind Singhania Thank you Gavin and thank you everyone for joining us on our earnings call. I would begin the discussions by highlighting that the operational developments, post which Pradeep will run you through our financial performance.

We have delivered a strong set of numbers for the quarter and nine months as can be seen in the financials. For the nine months we have delivered revenue growth of 32% while EBITDA grew 74%. The growth was majorly driven by film business. The other two businesses mainly Specialty Polymer and Engineering Plastic delivered somewhat softer performance. However we are undertaking steps towards strengthening the two businesses which should contribute positively to the overall business going forward.

Let me now discuss the performances of each of the businesses individually starting off with the Film business; as mentioned earlier the business continues to perform well on the back of steady demand and realizations. Business environment continues to remain favorable following demand supply parity. Only two additional production lines are expected to come on stream during FY20, general line by Q1 FY20 and another line by our competitor by Q3 of FY 20. Growth in demand has necessitated additions of capacity. Additional production to these lines is not expected to cause any major disruption in demand supply parity given the strong domestic and overseas growth in demand.

Moving on to the demand side – the trend seems to remain strong. Demand from packaging industry is strong and we expect the consumption trend to continue especially given the sops announced by the finance minister in the interim budget. In addition to the above we are also undertaking a number of steps internally to further build on to the momentum. One of the primary measures involves increasing the share of value-added product in the overall mix. As indicated in the previous call we aimed to increase that share to 30% by FY 20 which at present stands at about 21% to 22%. Such efforts will help us improve the margin and profitability profile of the business and also mitigate cyclicality to a large extent.

Moving onto Specialty Polymer business – The off-take for the same remained soft which in turn affected the overall performance of the business. The business's journey has remained somewhat challenging as reflected by the financials. We have made significant investments in terms of man-hours and product development. Despite the challenges though, we are hopeful that the business will pick up in coming year which would meaningfully alter the profitability trajectory of not only this business but overall business. The Stain Resistant Master Batch has in fact seen some growth in demand although not at the pace that we expected. We have added two customers albeit with smaller volumes. MB07, Deep Dyeable Master Batch has passed qualification test at various customers in USA, EU, China and Korea and we expect volumes to start building up during FY2020. There is a strong demand for the MB06 Cationic Dyeable Master Batch. However, this has been delayed due to product development issues. We are now clearly at the last stage in this respect and are confident that we will get reasonably good volumes starting from FY2020 itself. Apart from this, major headway has been made for our Low Melt LMFC05 product with the Korean customer and trials have been initiated with one very large American customer with potentially significant volumes once the product is qualified and the business case is made by the customer. We are also very close to finalizing the contract for the supply of special PBT product. We are unable to disclose name and other details of the same due to confidentiality clause.

Engineering Plastics business continues to deliver steady performance contributing positively to the overall business revenue. Profitability and margins though remain under pressure owing to higher input prices. We are however working towards mitigating the same by increasing the share of value-added products in the overall mix. Performance of Engineering Plastics SBU would have been much better but for disruption caused by extremely volatile Polymer prices influenced by fall in crude oil prices as well as US China trade war. This quarter also saw dip in demand from both electric and auto segments. We are confident of recovery in both volume and margins in this business from Q1 of FY2020.

Lastly, we are also undertaking multiple strategic initiatives to control and reduce cost. We are hopeful that such measures will help us reduce cost by Rs. 10 to 12 crore per annum. Cost savings of approximately Rs.5 crore on an annualized basis are already been achieved and the balance will be achieved in the course of FY2020. These have been brought about by the introduction of Process Based Organization (PBO) across the Company. This involves multitasking and automation of business processes which not only helps us reduce cost but also bringing in better efficiencies and achieve optimal utilization of resources. This will help us to preserve margins and profitability of the business. We have as we speak started seeing its impact and are confident that the same will help us in meeting out in ordinate expenses.

To conclude – let me reiterate that we are confident of delivering steady consistent performance going forward. Film business as well placed to meet the growing demand and should drive bulk of our growth in the coming years. Our efforts towards improving the product mix should further strengthen the business. Engineering Plastic business should continue to deliver steady performance and with better product mix should also contribute to the overall profitability of the business. Specialty Polymer business should pick-up in coming year complimenting the Film and Engineering Plastics business.

With that I hand-over the floor to Pradeep, who will run you through the financial performance.

Pradeep Rustagi: Good afternoon everyone and thank you for taking the time out for our call. I trust that all of you have received investor documents circulated by us earlier. Letme quickly summarize the key financial highlights for the quarter following which we can begin the Q&A session.

Starting with the top line, our revenues for the quarters stood at Rs. 270 crore as against Rs.202 crore reported during Q3 FY18, higher by 34%. While on a nine months basis the same stood at Rs. 773 crore as against Rs.587 crore reported during nine months FY18, higher by 32%. The growth was primarily driven by the strong performance of Film business. EBITDA for the quarter stood at Rs. 29 crore as against Rs.17 crore generated during Q3 FY 18, higher by 71%. While on a nine month basis the same stood at Rs. 83 crore as against Rs. 48 crore generated during corresponding period last year, higher by 73%. Higher revenue growth coupled with prudent cost management resulted in delivering higher profitability and margin expansions. Finance cost for the quarter remained at Rs. 9 crore while on a nine months basis the same amounted to Rs. 26 crore.

As on December '18 our outstanding term debt stood at Rs. 85 crore while interest bearing working capital liability stood at Rs. 191 crore. Interest bearing debt as multiple of EBITDA annualized basis stands at 2.49x as at 31st December '18. Term debt tangible net worth ratio stands at 0.29x and total outside liability tangible net worth ratio stands at 1.03x as at December '18. We are confident of maintaining debt equity at comfortable levels going forward. Term debt repayment obligation since last many years has been in the range of Rs. 40 to Rs.44 crore per annum. Out of term debt repayment obligation of Rs. 44 crore during FY18-19 Company had already paid Rs. 35 crore till 31st December, 18 and the balance Rs.9 crore will be repaid during Q4 FY19 when it is due for repayment. Starting from FY20, the term debt repayment obligation will reduce to about Rs.20 crore per annum. Prudent level of debt and reduced repayment obligation has helped the company achieved comfortable cash flow position. Comfortable cash flow situation would enable the company to spare surplus funds for future expansion.

Liquidity position of the company as indicated by Net Working Capital and Current Ratio has improved significantly with Net Working Capital at Rs. 52 crores and Current Ratio at 1.20 as at 31st December 2018 as compared to NWC of Rs. 4 crores and Current Ratio of 1.01 as at 31st March 2018..

Depreciation for the quarter and nine months stood at Rs. 8 crore and Rs.24 crore respectively. Profit after tax for the quarter stood at Rs. 8 crore as against profit of 48 lakhs reported during Q3 FY18. While on a nine month basis PAT stood at Rs. 23 crore as against the loss of Rs. 31 lakh reported during nine months FY18.

To conclude while Film business may continue to drive the growth in near term, we are hopeful that our efforts towards strengthening the other two businesses should also compliment and contribute to the overall growth of the business. That concludes my opening remarks. We would be happy to answer your questions now.

Moderator: Ladies and gentlemen we will now begin with the question and answer session. We take the first question from the line of Saket Kapoor from Kapoor & Co.

Saket Kapoor: If you could give how is the BOPET Film industry shaping globally also? I mean to say how are the big players globally positioned. Domestically you have already explained that theres not much capacity coming up with Jindal and other players you have not mentioned the name are coming up with the capacity in one year's time, how is this industry position globally and what kind of threat does it pose in terms of import for the country?

Arvind Singhania: The global demand growth is quite strong in Polyester Film industry. We are experiencing growth rate of about 4% to 5% on a global basis which is substantial number and on the domestic, the number is more towards 11% to 13% growth in demand. So Polyester Film demand is growing at a very steady pace, it has been doing so for the past many years and we expect it to continue with this growth rate in the coming years also. The largest capacities in the world if you were to talk about one block are situated in China. China has increased its capacity from a mere 50,000 tonnes in 2004 to more than 1.7 million tonnes or 1.5 million tonnes currently standing as of date. We are not seeing and we do not expect to see any further growth in capacity in China, purely because of the change in the dynamics in that country. The earlier situation as everybody knows, they used to have a phenomenal amount of expansion which was all Italian debt based and now that the situations are changed. So Chinese, while the demand continues to grow there is no expected new capacity. There is some grow taking place in the international market also. There is a line coming up in Bulgaria, there is a line coming up in Indonesia and most of this is driven by the Indian producers of PET Film. So we are seeing growth in capacity but the growth in capacity is not abnormal, it is required to meet the growth in demand.

Saket Kapoor: What is the size of the industry if you could give more color to it, total global size of this PET Film industry?

Arvind Singhania: The domestic demand as of today is about 430,000-440,000 tonnes per annum. Growing at anywhere between 11% to 13%. So if you were to take these two new capacities coming up which are at about 80,000 tonnes per year and current demand of 440,000 tonnes and a growth of about 12%, we are talking about the growth in demand of about 53,000 tonnes per year. So that is the reason we are saying that the new additional capacity should not cause any major upheaval in the demand supply or therefore consequently into the margins of the business.

Saket Kapoor: But our market share is been going to fall because we are not contemplating any expansion as of now, so our consequently our share will go down.

Arvind Singhania: It will go down marginally with the startup of these lines. But we are now starting to look at take some decision in terms of increasing capacity in Polyester Film towards the end of the year.

Saket Kapoor: Now if you could throw some light on the raw material basket how have they behaved for the quarter and then nine months comparison.

Arvind Singhania: The December quarter saw the biggest volatility in raw material that we have experienced in the in the near future or even in the medium term future.

Pradeep Rustagi: We are taking PTA-MEG in a certain ratio and the PTA-MEG cost per kg of chips basically which is the raw material for Film. In the month of September it was Rs. 98 a kg, per kg of Film and then it went down to Rs.95 in the month of October and then Rs.82 in the month of November and Rs.72 in December. Now since December it is in the range of Rs.72 to Rs.74, January-February have been more stable.

Arvind Singhania: So basically what we are saying is it went down from Rs.98 to Rs.72 over a period of three months, in Rs. 26, almost the 26% drop in a matter of two months literally.

Pradeep Rustagi: Yes November and December saw the maximum fall.

Saket Kapoor: Now things are stabilized, now this is in the band of Rs.72 to Rs.75?

Arvind Singhania: Now we are at about Rs. 75-76 in that range.

Saket Kapoor: Further granular details, how was the pricing trend for MEG as well as PTA if you could give the breakup for them also.

Pradeep Rustagi: MEG, we saw the highest at Rs. 74 in mid-of September which is now down to Rs. 50 a kg and PTA was highest at Rs. 88 in middle of September which is now down to Rs. 67 a kg.

Saket Kapoor: This is what the prevailing prices are Rs.50 and Rs.67?

Pradeep Rustagi: This is Rs. 50 for MEG and this is net of GST landed at our factory and Rs.67 for PTA.

Saket Kapoor: Firstly, I would also like to congratulate your investor team also. This time the presentation was really elaborate and has covered many of the aspects with debt program also, how the repayments also. Many of our questions which we used to have on a continuous basis have been answered in your presentation, so kudos to the team for handling the presentation in the best way. For the next presentation if you could give some more information for the industry also, some few sentences on that then that would also save lot bit of time for more questionnaire.

Arvind Singhania: Thank you very much and we will ensure that we will give you industry scenario on the next time we have a con-call.

Saket Kapoor: The point which we investors, analysts are always looking at on the sustainability and the quality of these numbers. As you have guided that the numbers are going to improve going forward, so just give more color on it 'now this Rs. 1 earning is there, Rs. 1 EPS we have done how sustainable are these numbers, what factors are there which give you the confidence that these numbers can be achieved on a consistent basis going forward? **Arvind Singhania:** First of all this is one rupee for the quarter, it's not annualized.

Saket Kapoor: Yes, sir.

Arvind Singhania: Like we said that we expect the margins to remain steady in Polyester Film going forward, because one line is expected to start up in the first quarter of this year and the second line will start up only towards the end of the next financial. So there will be a gap in the startup and the demand growth will we take up the slack. So we don't expect the margins to be hurt drastically going forward. So therefore, we expect the earnings to remain. On top of that we are taking a lot of stringent cost-cutting actions as we have already explained in our opening remarks. We have targeted to cut direct manpower cost by about Rs.12 crore per year, out of which about Rs.5 to Rs.6 crore has already been achieved on an annualized basis and the balance will be achieved by when I say the middle of the next financial year, so let us say by October of next financial we will achieve the balance Rs.6 crore. On a total March '18 our manpower cost in the balance sheet was about Rs.44 crore. We expect to bring these down to about Rs.32 crore by October of this year. Half of this has already been achieved. We will start a second step towards June July this year to further work on the process-based organization to further improve the efficiencies through the Process Based Organization. So cost-cutting has been taken up very extensively. Point #3, we are laying heavy stress on increasing the value-added product portfolio in our Film basket. We are now installing an off-line coater which will be ordered in the next couple of weeks which will begin production by the end of this calendar year. This will add substantially to the margins of the Polyester Film business. And on top of that we hope to be able to announce, we are considering very strongly to go in for an expansion which we hope to be able to take a decision by the end of this year as well.

Moderator: Next question is from the line of Aman Sonthalia from AK Securities.

Aman Sonthalia: How is this trade in the BOPET, in Q1-Q2-Q3 and right now?

Arvind Singhania: The spread in the margins you mean?

Aman Sonthalia: Yes, Sir.

Pradeep Rustagi: We define this gap as the gap between selling price and raw material as a value addition. So, in September quarter it was Rs. 46, domestic it was Rs.46 and it came down to Rs.42 because of the raw material volatility in the December quarter. In exports we could achieve Rs.48 and then substantial increase in the December quarter to about Rs. 65.

Aman Sonthalia: Rs.65 in the September quarter?

Pradeep Rustagi: You want June quarter numbers as well? June was Rs. 45 then it increased to Rs.46 then it was in the range of Rs.44- Rs.45; the exports and domestic put together. Matelasse was always in the range of over and above Plain Film in the range of Rs. 21 to Rs.22. So, the margin has been pretty typical in the current financial year.

Aman Sonthalia: So how is the current margin as on date?

Pradeep Rustagi: Currently the Film 12-micron Corona film being sold at about Rs.123 with raw material cost of about Rs. 75, we are in the range of Rs. 45 to Rs. 50 a kg.

Aman Sonthalia: So it was around Rs.42 in the December quarter?

Pradeep Rustagi: Yes December quarter, the November month was very bad.

Aman Sonthalia: So there is an increase of around Rs. 5 to 6 in currently right now?

Arvind Singhania: **Yes,** currently now we have increased. but that was not the whole quarter. The month of November itself was very bad because the demand shrank because of the drop in the raw material by about Rs. 25.

Aman Sonthalia: So overall if you see the margin, take the average of December, I think it is for Rs.4 or 5 higher than the December quarter margin right now?

Arvind Singhania: Yes, I would say about Rs. 3 to Rs. 4 will be higher.

Aman Sonthalia: How is the margin outlook going forward?

Arvind Singhania: I think we will be able to maintain these kind of margins.

Aman Sonthalia: Any chances of going to be better than this margin?

Arvind Singhania: I would not hazard a guess that we will go better than this but I think it will remain in this. It will be range bound between Rs. 45 and Rs.50.

Moderator: The next question is from the line of Rajesh Agarwal from Moneyore Investment.

Rajesh Agarwal: What is the update on Specialty Polymers and are we seeing any traction in that?

Arvind Singhania: Yes, actually the financial year FY19 has been very-very abnormal and slow and we didn't see much traction take place in this year. But starting with this new calendar we have seen some traction starting and which I have explained in my opening statement also. We have seen the addition of two new customers for our MBO3 Stain Resistant Master Batch. Not with the same kind of volume that we are expecting but we have added two more customers for this product line. We are hopeful that this will continue to grow as we move forward. Apart from this there are 3 or 4 other products which are very interesting, our MB07 which is been working on for the last 2 to 3 years. This has finally achieved customer qualifications on across the world; from America, from Europe, Turkey, Thailand, Korea and China. So, we expect to start building on volumes starting in the next 2 or 3 months. MB06 Cationic Dyeable which has a very strong demand has been delayed because of product development issues. We are now mostly overcome this problem and we hope to start getting customer qualifications in the next few months, so we expect to see some volumes from this product also in FY20. Apart from this LMC05 which is our low melt has got customer qualification from one big customer in Korea where we expect to get volumes and one very large customer in the US is working on a new product with this Polymer of **ours** and if this goes through and they are able to build up business case it could turn out to be something very large. But this is a longer-term thing which may take maybe next 6 months to 18 months to fructify. We are also on the verge of signing a contract with very large MNC something we have been working on for the past one year. This is for a special PBT, Polybutylene Terephthalate product for a consumer electronic industry and we are hopeful of signing the contract in the next week.

Moderator: The next question is from the line of Rajeev Gupta from RPC Financial.

Rajiv Gupta: Could you put a number to the inventory loss on crude based raw material and the absolute number for this quarter?

Pradeep Rustagi: So, we have suffered some losses on the finished goods which is about Rs. 2 to 3 crore.

Moderator: The next question is from the line of Saket Kapoor from Kapoor & Co.

Saket Kapoor: Just to move forward with the last speaker question, the EP business is more impacted by the raw material volatility than the Film business, isn't it?

Arvind Singhania: Yes, the reason being that the Polymers for the Engineering Plastic business are all imported, because these Polymers we don't make ourselves. We in the Engineering plastic business we use PBT, PC, PA66, ABS etc. Now all these Polymers are imported. Since there was a big decline in the price of polymers in the month of October-November and December we took a very big hit in terms of margins and volume in this business and we are yet to start recovering because the inventory losses here were higher than the Film business, because film business; the entire raw material is locally sourced so we don't have that much inventory with us.

Saket Kapoor: So out of this Rs.2 crore which is what portion will be attachable to the Engineering Plastic and how much to this Film segment?

Pradeep Rustagi : Majority of this is engineering plastics only.

Arvind Singhania: It's not really counted as an inventory loss because we take a hit in the margin. So, this is very difficult to identify that as the inventory loss per se.

Saket Kapoor: For the Specialty Film what was the revenue for this quarter?

Pradeep Rustagi: In volume terms 21% of the film is value-added and Specialty Films. In terms of revenue 28% to 29% of the revenue has come from value-added Films.

Saket Kapoor: That is the premium of Rs.15 to 20 that we get?

Pradeep Rustagi: There is a marginal increase in cost also.

Saket Kapoor: The Metallurgical part I things of which you have explained.

Pradeep Rustagi: Metallurgy is one part, this coating different chemicals are coated.

Saket Kapoor: Firstly, as the second speaker speak about the margin part, it is Rs. 45 for the basic category and Rs. 60 for the export or the specialized films?

Arvind Singhania: No, Rs.60 for exports and Rs.42 for domestic.

Saket Kapoor: What is our mix, domestic sales and the export part?

Pradeep Rustagi: 70% is domestic and 30% is exports.

Saket Kapoor: In the domestic, any of our consumer buyer having more than 10% of our requirement who buys more, do we have customers who are buying…?

Arvind Singhania: There is only one very large customer which is Huhtamaki Paper Product, HPPL not on a regular basis but some months he can become 10% or more.

Saket Kapoor: Are JBF people also aligned with us, you were talking about some specialty in lines coming in Bulgaria and all so, is JBF in any way competitor?

Arvind Singhania: No, JBF not a competitor.

Pradeep Rustagi: They have three lines in Bahrain but only I believe that only one line is running.

Saket Kapoor: In Bahrain? They are competing in this BOPET Film segment only with us?

Arvind Singhania: Correct.

Saket Kapoor: I was also looking for the seasonality factor. So, in our business do we have that seasonality factor playing with our customer in any of the quarter if we take H1 and H2 or Q1-Q2-Q3-Q4 which part is heavier where there is the slack period? Is there anything that which you also keep in mind?

Arvind Singhania: There is really not the seasonality factor in our business per se. If you were to talk about and compare it to a soft drink business which is heavily seasonal; in summer months and versus winter months specially in north of India. In our business it's not really that seasonal. We have some small dips during Diwali etc. but that's largely because the Industry basically shuts down for a little bit so a week or 10 days just at the time of Diwali or Holi we have a small dip for a few days but it's nothing majorly seasonal.

Saket Kapoor: Quarter 4 should also be in line with as Quarter 3 was, because last year things where slightly different between Quarter 3 and Quarter 4 so that was the reason why I was dwelling on the point.

Arvind Singhania: We feel that Quarter 4 should be in line or better.

Saket Kapoor: Lastly sir, the consumer preference, it's changing from Plastic now to Glass or other Melamine and other products so what are the threat and pain points in our industry and how well our company equipped to handle this disruptive force going forward?

Arvind Singhania: No, first of all I don't know where you got the impression that there is a shift from plastic to glass.

Saket Kapoor: I'm talking about PET as an industry user; the PET bottles and all where there is a raw material; I think so the PET users which I was trying to make sense that there is a shift in consumer preference from PET to other grades?

Arvind Singhania: We don't see anything to the likes of what you are saying.

Pradeep Rustagi: PET Resin has a very good growth and demand.

Arvind Singhania: PET films or PET Resin they have a very good growth in demand, and we are not aware of any specific change towards any better because there is no other better product available. Yes, there is a very strong stress on recyclability. And not only recyclable but there is no other product which is a challenge today whether be it in bottles or in flexible packaging in terms of Polyester Film to challenge these products there is no other better product available. If you are aware please let us know which product is this.

Saket Kapoor: Which are the threat points or the pain points for the industry where we need to work or our industry need to improve? Which are the areas of the more work needs to be done?

Arvind Singhania: In terms of the industry like I said recyclability is a major concern, environment is a major concern. Like in the PET bottle industry we have a collection rate of 95% where scrap bottles are collected and reused. Now the same thing has to be brought into flexible packaging industry as well, and the industry is working very strongly along with the primary producers, the brand owners to bring about an ecosystem and to create an ecosystem similar to that what is being created for PET bottles to collect plastic waste and to be able to reuse it. Now technologies are available today with the industry to be able to use scrap film waste, laminate waste and to use it for various applications. The only problem is that we have to establish an ecosystem similar to that of scrap bottles where by the collection can be done and given to the industry who can convert it back into a lower value product and sell it. So, that will take care of the environment issue also.

Saket Kapoor: Currently any imports; what percent when imports happened in the film category?

Arvind Singhania: No, there is negligible import. There is no import.

Saket Kapoor: We see this Polymer hoardings also now taking, the big boards and all any part of our products being used for manufacturing of these hoardings also, do we find our application there?

Arvind Singhania: No. Our product is Polyester Film largely goes for flexible packaging.

Moderator: Ladies and gentlemen that was the last question. I would now like to hand the conference back to the management for their closing comments.

Arvind Singhania: Thank you very much everybody for joining in on the con-call and we look forward to seeing you again after the close of the financial year FY19.