Ester Industries Limited

Q4 and FY17 Earnings Conference Call Transcript
June 5, 2017

Moderator Ladies and Gentlemen, Good Day and Welcome to the Ester Industries Limited Q4 and FY17 earnings conference call. As a reminder, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. I now 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 Limited Q4 and FY17 analyst and investor call. We have with us today Mr. Arvind Singhania – Chairman, and Mr. Pradeep Kumar Rustagi – Chief Financial Officer. We will begin this call with opening remarks from the management following which we will have the floor open for an interactive Q&A session. Before we begin, I would like to point out that certain statements made in today's discussion may be forward-looking in nature and a note to this effect was stated in the con call invite sent to you earlier. We trust you have had a chance to go through the presentation. I would now like to request Mr. Singhania to make his opening remarks.

Arvind Singhania Good afternoon everyone and welcome to Ester Industries Q4 and FY17 earnings conference call.

Let me start by taking you through some of the key operational developments following which Pradeep will run you through our key financial highlights for the period.

FY17 has been a challenging and a learning year for us. I say challenging because the business failed to gain any meaningful momentum throughout the year and I say learning because of the way our Specialty Polymer business performed. Specialty Polymer business as I have said during my past interaction is largely innovation-driven and as a result, we have learned it is very hard to predict and see how it will unfold. The products are breakthrough innovations and not just substitutes. One hence does come across significant hurdles on a recurring basis, but the reward makes the journey worthwhile.

Let me start the discussion with Specialty Polymer business:

Performance of the business remained soft. The anticipated pick up in the business failed to materialize which led to significant contraction in the revenue and profitability for the business. Some of the prospective order from clients failed to translate tangibly which further impacted the business. While the current year performance of the business has not gone as per plan, we continue to remain positive on the business and look at this year's performance as a mere delay in reaching our eventual course. One of the key initiatives that we took during the year was the announcement of our intent to set up an R&D and Innovation Center. The rationale behind proposing to set up the Innovation Center is to move functions like downstream analytics, pilot scale manufacturing in-house as against current practices of outsourcing it. The advantage of undertaking such activities in-house is that it helps curtail the product development to market cycle.

One of the reasons holding back the momentum in Specialty Polymer business has been the delay from clients end in confirming the order. While product stability has been less of an issue, the pressure point has always been in getting the go ahead signal from the client. One can understand the time taken by customers as well as accepting something new always faces certain resistance. However, as mentioned earlier, we believe it is just a short-term challenge which could clear out in the near term. The facility when set up will house about 40 scientists and engineers who will be responsible for continuously researching and developing breakthrough innovations.

Moving to some of the key operational developments during the year:

We filed for a new patent under PCT for a master batch to produce specialized polyester yarn. The master batch is for a cationic dyeable yarn, which offers value advantages both from a quality and cost perspective. This product has already been approved by some Indian entities and is believed to enjoy a strong potential in China and Taiwan. With this latest filing, out patent tally becomes nine, of which we have manufactured a total of 18 products. The product pipeline for the business remains strong. Some of the key products we are working on are ESPET MB 06 test master batch for imparting cationic dyebility, cost effective and less time consuming process, ESPET MB 07 R7 is the pet master batch for imparting easy dye-ability using dispersed dyes, different fabrics can be dyed in the same bath and various colors and patterns can be produced. ESPET T 55, which is an alkali soluble PET, it dissolves in alkaline solution at specified temperature within a specified time thus enabling fabrics of special design effect. ESPET ED MB 01, this is a deep dyeable PTT, developed for getting deeper and darker shades in carpets and apparel, this has particularly being done for DuPont.

Further, we are also collaborating with global players for developing different types of specialty polyester polymers. During the year, we entered into a tie up with DuPont for development of specialty polyester polymers for niche applications. We believe that such association will not only help us improve our knowhow, but also help us pass in our learning curve. The above actions lend us the confidence that despite the near-term challenges, we continue to progress and move ahead on the right track. Specialty Polymer business will continue to remain the catalyst in transforming the business.

Moving on to the legacy businesses:

Performance of both polyester film and Engineering Plastics were encouraging. Speaking about the film business first, the macro environment appears to be gradually improving with the demand supply situation finally looking to attaining parity in the near-to-medium term. Further, no major capacity addition is expected in the next 18 months to two years. Our focus of the business remains towards improving the product mix and control cost. The goal is to increase the share of value added products towards 35% from the present almost 20-21%. For Engineering Plastics business, our focus is towards enhancing relationship with OEMs and Tier-1, 2 customers in the automotive electrical segments. Expand global footprint through aggressive pursuit of identified export opportunities and participation in international exhibitions to enhance brand visibility and build R&D capability in-house or true strategic alliances to cater to specific needs.

To conclude, I would like to reiterate that we continue to remain positive on the business and view the current challenges surrounding Specialty Polymer as purely short-term in nature. We are also undertaking steps towards accelerating the business and retain our positive outlook. We are also focused on increasing share of value added products in the polyester film business to about 30-35% and improve its margins to 13 to 14%, and to take the margins of Engineering Plastic business to 11 to 12% from current levels of 7-8%. 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 the investor's documents circulated by us earlier. Let me quickly summarize our key financial highlights for the year and we can begin the Q&A session.

Our revenue for the year stood at Rs. 707 crore as against 771 crore generted during last year. Lower primary on account of especially polymer sales and no polyester chip sale during the period as against Rs. 20 crore chip sale during previous year. Core EBITDA for the year stood at Rs. 55 crore as against EBITDA of Rs. 75 crore generated during FY16. We had few exceptional expenses during the year of Rs. 2 crore on account of reversal of Modvat credit availed during the year 1996 - 98 pursuant to court order, Rs. 5 crore inventory write down and Rs. 2 crore external contamination in an export shipment. Loss after tax for the year stood at Rs. 11 crore as against PAT of Rs. 5 crore generated during last year.

Moving on to segment-wise performance Specialty polymer business reported annual revenues of Rs. 43 crore as against Rs. 67 crore generated during FY16. Adjusted EBIT for the business stood at Rs. 4 crore as against Rs. 12 crore, the reported EBIT is post consolidating a quality claim of €275,000 allowed in favor of a Specialty Polymer customer. This is one-time charge and was the result of a contamination impact on a shipment. Polyester film business reported revenues worth Rs. 519 crore for the year as against revenues of 549 crore generated during FY16 lower by 5%. Adjusted EBIT for the business stood at Rs. 51 crore as against previous year's Rs. 61 crore. Here too the reported EBIT includes a one-time slow moving finished goods inventory of chips and pellets following principal of lower of NRV or cost. NRV is about 493 lakhs lower than the cost in respect of such inventory. Going ahead given the improving macros and our focus on an improving product mix, we are hopeful of delivering better performance.

Performance of the plastic business in margin terms improved slightly during the year and reported EBIT margins of 9.3% as against 8% during previous year. Revenue from the business stood at Rs. 145 crore as against Rs. 55 crore reported during FY16. As mentioned earlier by Mr. Singhania, we are working towards enhancing relationships with OEMs and Tier-1 and 2 customers and widen geographical presence. That concludes my opening remarks, we would be happy to answer your questions now.

Moderator The first question is from the line of Saket Kapoor from Kapoor and Company.

Saket Kapoor Sir, I was asking about how the growth story is panning out, what is the timeline we as an investor should look in to the growth story playing out as per your projections, and secondly, what was the utilization level for this quarter as a whole all plants together?

Arvind Singhania All plants together it is difficult, but given it is almost 93% in polyester film, in EP we are close to 70% capacity utilization, and as far as Specialty Polymer is concerned, you cannot really give a number to it because total capacity is between 20,000 to 30,000 tons per annum.

Saket Kapoor Sir, actually interest part and the depreciation is the one that is bothering the bottom line, so when can the bottom line look healthy, when it will be covering the interest part, what is our debt level as on March '17?

Arvind Singhania Please understand that even in the past we had been able to cover our entire interest and depreciation, FY17 was an aberration, was actually one-off, a bad year I would say and because of the over capacity created in polyester film, the margin got hit badly and that is why you saw that as an aberration, but rest assured that from the current year itself onwards, we will be in the black again.

Saket Kapoor For the year you are giving the guidance or every quarter we are in a position to post?

Arvind Singhania We are not a quarter-on-quarter company, but for the year I am giving the guidance that we should be in the black.

Saket Kapoor We will be able to cover both the interest and depreciation?

Arvind Singhania Yes.

Saket Kapoor Sir, what kind of volume bump up can we see from the incremental volume that may come up due to your this R&D filing of the patent, the new products coming up, if you could throw some more light?

Arvind Singhania In terms of polyester film, we are actually constrained by capacity, so we are expecting just a marginal increase in volume by about 3-4%, so that will mean about a marginal increase in turnover from the film. In Engineering Plastics, we expect our turnover to go up from about Rs.145 crore to about Rs.190 crore for this year, so there will be a substantial increase in the turnover of Engineering Plastics. In the Specialty Polymer, right now we are projected very conservatively looking at the historical experience, but there are some projects which are on with the customers which may kick in towards the second half which will help improve the bottom line as well.

Saket Kapoor Sir, you told about capacity constraints, what are those constraints and how are we going to …?

Arvind Singhania Capacity constraints in polyester film is that we are already running at almost full capacity. Now, if we want to add, we will have to look at major CAPEX, which we will start considering towards the latter part of this year.

Saket Kapoor Debt part if you could give some more color to what is the debt as on March '17 and what should we look for in the next year?

Pradeep Rustagi Our debt on March 31, if you divide into working capital and term debt, working capital is about Rs.200 crore with Rs.100 crore of term debt. Out of that Rs.100 crore, close to Rs.40 crore will get repaid during this year, so overall there would be some reduction during this year in the overall interest bearing debt that we would have on March 31, 2018, would be lower as compared to March 31, 2017.

Saket Kapoor What is the cost of fund, Sir?

Pradeep Rustagi Average cost of fund is about, if you leave aside the bank charges, the average cost of fund is about 10% per annum.

Saket Kapoor What is the absolute number for the bank charges?

Pradeep Rustagi Bank charges out of the Rs.32 crore interest cost that we have finance cost, 4 crore is on account of bank charges.

Saket Kapoor These charges will remain during the regular course of business?

Pradeep Rustagi These charges will remain almost the same, it is transaction cost that we need to pay to the bank. Interest cost with repayment will gradually reduce.

Saket Kapoor One of our shareholder, Vettel International holds 15.5%, so that the benefit which you spoke for which we allotted the shares to them, how are the benefit being accrued now to the company or whatever we have made the program, have we got all the benefits as per our programming?

Arvind Singhania Well, the benefit that we assume that we will get were mostly in the beginning where all the introductions took place and we were able to get a foothold into the customers because we did not have any knowledge of those customers, so those largely those benefits have accrued, but it is an ongoing exercise as and when we need the help, they are always available.

Saket Kapoor Is there any agreement that will get expired, any clause with them or it is just a verbal?

Arvind Singhania No, there is no written agreement.

Saket Kapoor The promoters are related to them in any way?

Arvind Singhania No, we are not related.

Moderator The next question is from the line of Giriraj Daga from KM Visariya Family Trust.

Giriraj Daga Couple of questions, first you said that in the Specialty Polymer we have target very conservatively, but you did not give the number, what was the number revenue you are looking for this year?

Arvind Singhania Little over Rs.40-Rs.50 crore.

Giriraj Daga Can you help me with the volume number for this year in Specialty Polymer, 16-17?

Pradeep Rustagi In 16-17, volume we did about 2,700 tons as compared to 3,500 tons last year

Giriraj Daga Just a clarification that last year our annual report says about 4,100, Specialty Polymer, so that is in different…?

Pradeep Rustagi 3,540 is the Specialty Polymer last year with turnover of Rs.67 crore.

Giriraj Daga If you can also help me with the polyester chip and PET film's volume, Engineering Plastics, if you have handy?

Pradeep Rustagi Polyester chips we did about 600 tons last year, we used to sell only to one customer who used to make polyester film out of it. They have put up their own plant, so there is no sale of chip during this year. In film last year, we did about 49,000 tons, this year we have done close to 51,000 tons. Engineering Plastic, there has been no improvement as against the 11,000 tons, the numbers this year is also same.

Giriraj Daga Next question is related to our margins on a polyester film, if I look at this quarter margin, it is decently better at margin of about 13% kind, you spoke about 3-4% revenue growth, but what kind of margins we should, should we assume this kind of current spread of last quarter spread continue in this year?

Arvind Singhania Like I said that overall we see a more balanced demand-supply situation over the next two years because all the capacity that had to come have already been started. Now, for the next 18 months to two years we do not expect any new capacity to be added. On top of that, we had seen a very healthy growth in demand for polyester film. We are now experiencing growth in demand by about 12-13% per annum which used to hover around 7-8%, so this brings us to believe that the outlook for the polyester film business is very positive for the next two years, so you can derive your own meaning out of that I think at least the same if not better going forward.

Giriraj Daga My next clarification is that in our Engineering Plastic business, we are talking about revenue of somewhere of Rs.190 crore from Rs.145 crore, what is driving that?

Arvind Singhania Again, this business requires a lot of qualification from customers at least OEMs, Tier-1, Tier-2 customers. We have been working with many of them and the qualification time for products can be up to two years in some cases especially with automobile companies, so a lot of these approvals are expected to come through this year we expect to build significant volume. On top of that, we expect the OFC business to be much better. Last year, the tenders were delayed and that is why we could not increase the volume of OFC. We expect the OFC business to improve in 17-18. Last year also, we were impacted by the demonetization for couple of months in this business, so this is not here. Now the only thing that is open ended is the GST, what kind of impact that will have and also our export business is looking to build decent volumes starting from 17-18, so all these things put together we believe that we will have a significant increase in revenue from the Engineering Plastics business.

Giriraj Daga Would you be able to give some subjective numbers like what are the number of OE approval you got in the last year which you are thinking should cultivate into result this year?

Arvind Singhania That business head would know that exactly and he is not here right now, so I would refrain from giving any guess numbers here.

Giriraj Daga My last question is related to our Specialty Polymer side, like when we say Rs.40 to Rs.50 crore, would you be able to give some break like what kind of product are we talking about like master batches for nylon or hot-fillable, what kind of product which we are expecting to pickup this year and where we are in terms of approvals with the customer, some further detail on the customer approval side?

Arvind Singhania Well, we have covered many kind of products, it is not only one product, so for example, these are not different customers or different products that they are buying, so we have a customer in India who is doing a substantial volume with us for a special product which is for a rayon like polyester, so it is a very specialty product that we have developed and he is our customer for it. We are doing easy dyeable, we are doing flame retardants, we are doing low melt polyesters, there are various kinds of product that we are doing across the board.

Giriraj Daga Objectively if you can put the number like any number of customers which you are looking to target or get revenue from this year?

Arvind Singhania The number of customers would be in the region of about 15 to 20 customers.

Giriraj Daga Across all product segments?

Arvind Singhania In Specialty Polymer we do not have a large number of customers because it is a special product and each customer almost has its own specification that we have to cater to.

Giriraj Daga On this nylon carpet, we had earlier talked about getting some large customer, where we are in that process?

Arvind Singhania We are not seeing any large customer come through, there are headwinds we have faced because of various reasons, but I do believe that we will develop a reasonable market in Europe, Turkey, and in China over the next few months.

Giriraj Daga Your customer what you were talking about no longer like we are in the target list?

Arvind Singhania There is a very big customer in the US who is still thinking about it, but we had no positive indication that he will start buying large volumes any time soon, but overall we do expect a decent business coming out of this not to the extent that we had projected earlier in terms of 4000-5000 tons per year, but certainly a decent volume business can develop in this product in the next five to six months.

Moderator The next question is from the line of Vaibhav Goel of Dolat Capital.

Vaibhav Goel Sir, I have couple of questions. First is regarding the Specialty Polymer, so can you please share some light on the product pipeline for the Specialty Polymers?

Arvind Singhania Like we mentioned in our briefing that we got four or five products in the pipeline right now which are undergoing evaluation so that is the cationic dyeable master batch, the easy dyeable master batch, the alkali soluble polymer and of course the deep dyeable easy dyeable PTT, this is specifically for a company in America developed in collaboration with DuPont. Apart from that, we have many about seven or eight other products in the pipeline which of course at this point in time, I have to refrain from talking about them because of confidentiality.

Vaibhav Goel Sir, how is the performance of the current specialty products in the last year?

Arvind Singhania The performance like I said of Specialty Polymers as a whole was not very encouraging compared to last year. Last year, we had had higher turnover. This year we did only about Rs.41 crore and we have faced our headwinds in this for various reasons, basically product acceptance has not been a problem but headwinds due to various other reasons had been there, due to which we have not been able to ramp up the volume as we wanted to do it, so we are hoping that, even this year we have been very conservative in our approach in terms of our projections and we are hoping that some of the products which are under evaluation may bring in better volume for the second half, and therefore, we might be able to do better than what we have projected but this is something that we have to wait and see.

Vaibhav Goel My next question is on what is the timeline for the commencement of the R&D center in Gurgaon?

Arvind Singhania We will start work on it in the next few months and it is going to be done in a phased manner. It is not something that is going to be done overnight, so it is basically we will do very, very small investments over a period of time to continue to add as per the requirement of our R&D facility.

Moderator The next question is from the line of Arya Dipak from Bulls and Bells.

Arya Dipak What is the contribution percentage of the sales in the last quarter?

Pradeep Rustagi The contribution currently would be about 23% to 24% in the month of April and May of this year, we have seen contribution level of about 22%.

Moderator The next question is from the line of Giriraj Daga from KM Visariya Family Trust.

Giriraj Daga You said Engineering Plastic margins about 11% to 12% versus 7% to 8% if I heard correctly?

Pradeep Rustagi EBITDA level.

Giriraj Daga Anyway this year Engineering Plastics EBIT was 9.2%?

Pradeep Rustagi This is as per the segmental results you have seen 9%, but there are certain common expenses which are not loaded onto the segmental results, so when we say EBITDA, there is a loading of the common expenses on to the business and then we look at the EBITDA, so EBITDA after considering a certain loading of common expenses would be about 11%. On a like-to-like basis, it is likely to be better than 13% in the following years.

Giriraj Daga You are expecting this to be about 300-400 basis points higher that is what my understanding, correct?

Pradeep Rustagi I would say 200 to 250 basis points for FY18.

Giriraj Daga Okay, and in terms of Specialty Polymer would you like to give any margin guidance?

Arvind Singhania Again it is very difficult right now because volumes projected are low, we are expecting about Rs.40 to Rs.50 crore.

Giriraj Daga It is more or less same compared to last year, you do not expect any growth this year?

Arvind Singhania This year right now we are not projecting, we are being extremely conservative going on the historical experience, but we are hoping that in the second half of this year, we have been positive with the outlook of it, it is just that it is taking more time than we expected.

Giriraj Daga In terms of our debt thing, do we expect this Rs.40 crore payout to happen or we expect refinancing to take place?

Pradeep Rustagi We would be able to repay the kind of EBITDA that we are projecting to achieve this year and the headroom that we have is good enough to be able to service this debt.

Moderator Thank you. Ladies and Gentlemen, that was our last question. I now hand the conference back to the management for closing comments. Over to you, Sir.

Arvind Singhania Ladies and Gentlemen, thank you very much for attending the Q4 and FY17 earnings call for our company. Thank you very much.