Ester Industries Limited

Q2 and H1 FY18 Earnings Conference Call Transcript
December 14, 2017

Moderator Ladies and gentlemen, good day and welcome to the Ester Industries Limited Q2 and H1 FY18 Earnings Conference Call. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. I now hand the conference over to Mr. Gavin Desa from CDR India. Thank-you and over to you Mr. Desa.

Gavin Desa Thank you. Good day everyone and welcome to Ester Industries Q2 and H1 FY18 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 at some statements made in today's discussion maybe forward-looking in nature and a note to this effect was stated in the concall invite sent to you earlier. We trust you have had a chance to receive and go through the documents and financial performance.

I would now like to hand over to Mr. Singhania to make his opening remarks.

Arvind Singhania: Thank you Gavin. Good afternoon everyone and welcome to Ester Industries Q2 and H1 FY18 Earnings Conference Call. I will briefly discuss the key operating developments, post which Pradeep will run you through our key financial highlights for the period.

So H1 FY18 has been a relatively stable period for us. While we have not been able to deliver a stronger performance as what one might have hoped for, but we are pleased with what we have been able to achieve given the prevailing business environment.

Just to touch upon the headline numbers, we grew our revenues by 17% with significant reduction in loss after tax from Rs. 6.42 crore to about 53 lakhs on a half-yearly basis.

Moving on to business wise performance, I will start with Polyester Films first:

Our efforts towards enhancing the value-added contribution to this business combined with cost reduction, is showing results. Performance for the quarter under review has been impacted severely by GST transition related issues. However, on an overall basis, we are optimistic that these initiatives will deliver increasingly well as we go forward. The business fundamentals too have turned for the better, especially with demand-supply approaching parity. We do not expect any meaningful capacities to come on screen over the next few years as well. Our aim is to increase the share of value-added products to 35% in the overall product mix over the coming years from the current level of 20%. Share of value-added products in the overall mix is estimated to be 25% during the quarter ended March 2018. So we expect an exit rate of about 25% which is expected to grow to 35% by March FY19.

Moving onto Specialty Polymer business, while the financials for the same continue to remain subdued at present, we retain our faith and our confidence in the business' future potential. At present, lower off-take and longer than anticipated time from customers-end in confirming orders continue to affect the business. However, we are seeing the environment stabilizing and are hopeful of delivering a more consistent and stable performance going forward.

I am happy to inform you that one of our key customers for our stain resistant polymer has resumed offtake and we are optimistic of continued pickup not only from this entity from other players too. Another positive development is regarding PET Resin for draught beer kegs. This project had been put on hold for almost 2 years. The same has been revised as trial with the European customer has restarted. While the volumes maybe on the lower end at present, we are confident of scaling it up with time. Product pipelines for the business as well remains strong on the back of sustained investment towards R&D and developing executional capabilities. We are also pleased to state that we filed one more patient under PCT - a Modified polyester masterbatch for textile applications and manufacturing process thereof. The product facilitates easy dyeability of Polyester Fiber and provides deep dyeing through cationic as well as disperses dyes. Our patent filing stands at 7 as of date. We believe that Specialty Polymer will be the key catalyst in transforming our business. In the meanwhile, we have been granted patents in USA for two of our products namely the MB-03 which is the stained in master batch and the hot-fill product HR-03. These two patents have been finally granted to us in the US.

Moving on to Engineering Plastic business, our efforts towards improving the products mix by focusing more on value-added products is starting to pay dividends and can be seen by the performance during the first half. We are also focusing on increasing the depth of our product portfolio and such are undertaking necessary measures. We are hopeful that our efforts will help us in delivering steady returns going forward.

To conclude, I would just like to reiterate that our efforts continue towards transforming the business into one which is more technology and innovation driven. Combined with this, our continuing emphasis is on enhancing the contribution of value-added products in the overall mix and driving down costs.

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

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 documents circulated by us earlier. Let me quickly summarize the key financial highlights for the quarter and the half year ended September 2017, following which we can begin the Q&A session.

Starting with the top-line, our revenues for the quarter stood at Rs. 198 crore as against Rs. 163 crore higher by 21%; while on a half yearly basis the same (net of excise duty and GST) stood at Rs. 387 crore as against Rs. 331 crore reported during H1 FY17, higher by 17%. As mentioned by Mr. Singhania, we are pleased with our revenue run rate especially considering the fact that H1 was relatively challenging for the business. EBITDA for the quarter stood at Rs. 15 crore as against Rs. 9 crore generated during Q2 FY17, while on a half yearly basis the same stood at Rs. 31 crore as against Rs. 23 crore reported during H1 FY17. Margins for the quarter stood at 8% while on a half yearly basis the same stood at 8%. We have undertaken a number of strategic initiatives towards containing cost and improving product mix by focusing on more towards specialty and high margin products. We are confident that such measures will help us improve the profitability profile of the Company significantly in the coming years.

Finance cost for the quarter stood at Rs. 8 crore while on a half yearly basis the same amounted to Rs. 17 crore. Depreciation for the quarter stood at Rs. 8 crore while on a half yearly basis the same stood at Rs. 15 crore. Loss after tax for the quarter stood at Rs. 66 lakhs as against loss after tax of Rs. 5 crore reported during Q2 FY17; while on a half-yearly basis loss after tax stood at Rs. 79 lakhs versus loss of Rs. 7 crore generated during H1 FY18.

Moving on to the segment wise performance, Specialty polymer business reported net revenues of Rs. 14 crore as against Rs. 4 crore generated during Q2 FY17; while on a half yearly basis it remained relatively stable at Rs. 26 crore. While the performance for the business remained relatively soft, we are seeing things improve gradually and are hopeful of delivering a much better performance over the coming years.

Polyester film business reported revenues worth Rs. 142 crore during the quarter as against revenue of Rs. 126 crore generated during Q2 FY17; while on a half yearly basis the same stood at Rs. 277 crore as against Rs. 236 crore reported during H1 FY17. As mentioned by Mr. Singhania earlier, the sector fundamentals have turned for the better on the back of demand – supply parity and our efforts towards improving the product mix.

Performance of Engineering Plastics business continues to improve with revenues for the quarter and half year being Rs. 40 crore and Rs. 81 crore respectively, higher by 23% and 22%. Similar to film business, we are working towards improving the product mix for the business by focusing more on high margin products.

To conclude, I would like to reiterate that we are hopeful of delivering a stable and improved performance going ahead on the back of improved macros and Company's strategic initiatives towards improving its product mix. Further, on our cost rationalization efforts should also help us in delivering higher profitability going forward.

That concludes my opening remarks, we would be happy to answer your questions now.

Moderator: Thank you. We have the first question from the line of Saket Kapoor from Kapoor & Co. Please go ahead.

Saket Kapoor: Sir firstly, just wanted to know is there any seasonality effect for this quarter or are the numbers uniform for the first and the second half? I just wanted to understand the split of revenue. Sir what I am trying to understand is do we have any seasonality factor playing out for this second quarter of the first half and how does the revenue plan out for the year as a whole? What portion is booked in the first half and how much it is in the second half?

Arvind Singhania: Well, there is no seasonality factor as such but we were hit very badly with the GST in this quarter because it was implemented from 1st July, so that had a very severe impact on our film and engineering plastic business.

Saket Kapoor: By what percentage that lowered the performance, due to the GST impact?

Arvind Singhania: Due to the GST impact, the demand shrunk dramatically towards the end of June and in the July and August month. And due to which the prices fell very badly. Post August they have recovered again, they have started recovering. And the prices which had touched about Rs. 77-78 now stand at about Rs. 99. So this quarter was particularly affected due to GST. Now while this quarter was affected; the long term impact for GST is very positive for Ester.

Saket Kapoor: Just wanted to understand what is our market share for both of the verticals?

Arvind Singhania: In polyester film we are at about 9% and for engineering plastics it is a very tiny share.

Saket Kapoor: From the polyester film part who is the largest player in the country with what market share?

Arvind Singhania: I think that would be Jindal Poly Films; they would be close to about 18-19%.

Saket Kapoor: And JBS industry stands at which slot sir?

Arvind Singhania: No, JBS is not in the polyester film business. They are in the textile yard and PET resin business.

Saket Kapoor: For this quarter and the first half what was our utilization level? We posted revenue of around Rs. 400 crore.

Arvind Singhania: So polyester film was probably at about 95% and engineering plastics is at about 65%.

Saket Kapoor: Price erosion which we have witnessed, that was in the polyester film part only?

Arvind Singhania: Film and volumes dropped in Engineering plastics.

Pradeep Rustagi: Even the margins in domestic market came under pressure in Engineering plastics because of GST rollout.

Saket Kapoor: We have done 95% for the polyester film part that means there was no problem for the volumes.

Arvind Singhania: Yes, it was not a problem of volume; it was a problem of price erosion.

Saket Kapoor: So there was some taxation part that was from 3 and 4 GST that resulted in such erosion in pricing?

Arvind Singhania: Yes, it was because of GST and it is now recovered back. It is more than recovered back.

Saket Kapoor: How has the taxation changed pre and post GST for our products?

Arvind Singhania: Actually, it is industrial products and it is very neutral in the sense that earlier we were paying 12.5% excise duty and the customers were getting bandwidth credit of the same. Today we are paying 18% on our output and the customer is getting the credit of the entire amount. So it really does not affect the customers. It has increased from 12.5% to 18%. On the input and output both it is now 18%.

Moderator: The next question is from the line of Giriraj Daga from K M Visaria Family Trust. Please go ahead.

Giriraj Daga: Couple of questions from my side. You touched upon the point of prices, so what was the let us say average in second quarter? With Rs. 77-78 which was the low, what was the average in first quarter and second quarter?

Pradeep Rustagi: I will just give you the price for the average. You are talking about September quarter?

Giriraj Daga: Yes, I am asking for both; - September quarter and June quarter.

Pradeep Rustagi: It was about average of the export and domestic put together about Rs. 100 including the value-added products.

Giriraj Daga: Actually I am particularly looking at where the polyester films which tested low to Rs. 77-78.

Pradeep Rustagi: Well that is the base film in the domestic market. The price that I am giving you is a mix of metalized, plain, domestic and export put together including the value-added products; the total volume and total sales.

Giriraj Daga: And what would be the current same to same prices, like to like prices now?

Pradeep Rustagi: Something about Rs. 110-115.

Giriraj Daga: And has there been any increase in the cost also proportionately or no?

Arvind Singhania: Not much, raw material has gone up by about Rs. 4-5.

Giriraj Daga: The reason I was just asking this is because if I look at polyester segment number, we are one of the lowest EBIT margin this quarter. So can we go back to the likes of 13-14% which we had reported in the March quarter, that kind of margin?

Arvind Singhania: Polyester films with all the initiatives that we are taking in terms of increasing our value-added portfolio and reduction of cost, we are very hopeful to achieve numbers of 13-14% EBIT margin in FY19.

Giriraj Daga: EBIT or EBITDA?

Pradeep Rustagi: We do EBITDA at company level, not at product level because they have certain unallocated expenses. So at the business level we look at the EBIT on a segmental basis.

Giriraj Daga: So this 13-14% you mentioned is EBIT level margin, right?

Pradeep Rustagi : Yes.

Giriraj Daga: My second question is related to the specialty polyester. This quarter we have seen a decent jump in the profitability after a lull of five quarters. So has there been any, like obviously revenue has not gone up. Revenue has gone up from Rs. 13-14 crore only but the EBIT has gone up from Rs. 1 crore to Rs. 3 crore. So has there any been one-off there or is this is a new run-rate and what kind of a number you would like to give a guidance for this specialty polyester for the second half?

Arvind Singhania: Well, you are right. There was a one off number in the second quarter due to which there was an increase in the EBIT margin in specialty polymer. We were able to do a large volume of our state resistant product in this quarter. Going forward, we expect that it will be normalized with similar numbers but next year we are hoping for a substantial improvement in the specialty polymer business.

Giriraj Daga: Any particular guidance for FY19 on specialty polymers?

Pradeep Rustagi: This year we would be doing a turnover of about Rs. 45-50 crore in specialty polymer.

Arvind Singhania: Next year would be anything between Rs. 80-100 crore.

Giriraj Daga: In the engineering plastic side also we saw decent decline in margins obviously given the reason of GST hitting the volume. Although the revenues have not gone down, the margin has taken a toll. So should we expect the 3Q again to be in the similar situation of polyester films where the margins have come back to the normal level?

Arvind Singhania: Not really. In engineering plastics it is still a little subdued, it has not rebounded to the same level. I think it lasted longer especially in the electrical and electronic segment. The impact of GST downstream also has been hit because of the downturn in the construction and property development market which has affected it. So I think we will see another couple of subdued quarters in engineering plastics before things start turning around.

Moderator: The next question is from the line of Sachin Kasera from Lucky Investment Managers. Please go ahead.

Sachin Kasera: You mentioned that next year we are looking at a significant improvement in specialty polymers to Rs. 80 to 100 crore. In you look at the last 2-2.5 years, the specialty polymers has not performed as per expectations. So how confident are we of achieving this Rs. 80-100 crore number for specialty polymers in FY19 and secondly what is the margin in that case what type of mix we are seeing for that?

Arvind Singhania: Well we are quite confident of being able to achieve those numbers. These are based on certain customer feedbacks that we had got of where the approval of product has taken place and we are very hopeful of getting those volumes in 2018-19. So we are quite confident. So anything between Rs. 80-100 crore may be more I do not know, but I am just trying to be little conservative here. I do not want to sound very optimistic and over-optimistic. But I think once we are able to achieve a turnover of about Rs. 100 crore, I think we can expect EBIT margins of around 20-25%.

Sachin Kasera: What is the fixed cost that we have in this business of today that we are incurring?

Pradeep Rustagi: The fixed cost elements are salary, wages, the admin expenses, the finance cost and the depreciation and store & spares consumed. So all put together is about Rs. 1.6- 1.7 crore a month. Let us say about Rs. 20-21 crore a year.

Sachin Kasera: So that is the leverage that we have as and when the volumes start to improve?

Pradeep Rustagi: That includes the allocated portion of the common cost like finance, account, salary.

Arvind Singhania: For the common services, the allocated expenses are also included in that.

Sachin Kasera: My second question on specialty polymer was more of a medium-term nature. This obviously is seeing an improvement in FY19. But from a 3 to 5 year perspective what is the strategy here because I believe things have not taken the way we had expected in the last 2 years. So initially 2-3 years back we thought it could be like Rs. 500-600 crore business over a period of 5-6 years. Do you think that potential skill exists, or we need to skill down our ambitions in specialty polymer business per se?

Arvind Singhania: The potential certainly exists. To reach that number maybe Rs. 300-400 crore over the next 2-3 years.

Sachin Kasera: My second question was on the film business. You mentioned that I think this quarter you are at around 20% in terms of value add. You are looking at Q4 to be roughly at 25%, next year to be at 35%. So what is the type of improvement in performance we can see because of this way it has been going from 20% this quarter to 35% next year?

Arvind Singhania: There is a combination of three things. Number 1, is the improvement in the bottom line because of taking it from 20% to 35%. Our exit rate next quarter is at about 24-25% that is for sure. And we are very-very confident of being able to achieve 35% by FY19, the exit rate at FY19. This should add substantially to the bottom line of the polyester film business. I think overall, by FY19 we are looking at an addition of about Rs. 20-25 crore in terms of contribution margin, additional contribution margin. The second thing which has happened is the demand-supply gap. Now we have an effective capacity of about 52,000-53,000 tons is the effective polyester film capacity in India, per month. Currently between domestic we are selling at about 33,000 tons and 15,000 tons is being exported. So overall against the effective capacity of 52,000 tons, 48,000 tons is already being sold. That is in excess of 90%. The demand growth in polyester film in the domestic market is at about 12-13%. So we have almost achieved demand-supply parity and therefore new capacity is not expected for next 2 years. So with the demand growth, we expect that the next few years will be very good in polyester films. The growth rate is about 12-13% in demand and polyester films. And with the current demand supply almost reaching parity, I think the next few years will be very good for polyester films and third thing is that on the cost front we have undertaken a very big exercise to reduce the cost substantially over the next 12 months. So combined effect of all the three things we are looking at a significantly better performance in FY19.

Sachin Kasera: Any sense you can give on the EBITDA margins which you think should be achievable with all the initiatives that we are taking?

Arvind Singhania: It is currently at 8%, I can tell you that film business we are targeting that we should be at least about 13-14% in FY19. If we are able to achieve about Rs. 100 crore turnover in specialty polymer business, it will be in the region of about 22-23%. Engineering plastics will remain the same at 6-7%. But that is over a turnover of about Rs. 170-180 crore.

Sachin Kasera : In the polyester film business we are expecting EBITDA to improve from 8% to 13-14% in FY19 ?

Arvind Singhania: Yes

Sachin Kasera: My last question is regarding CAPEX and debt repayment for this year and next year, if you could give some sense?

Pradeep Rustagi: We are up to date with our repayments. The repayment obligation, the total term debt that needs to be repaid over the remaining period is about Rs. 14-15 crore this year and then Rs. 43 crore in the following year 2018-19 and then a very small amount of about Rs. 14 crore. So, total debt as on date is about Rs. 81 crore.

Arvind Singhania: The repayable term debt is about Rs. 81 crore.

Pradeep Rustagi: And on the CAPEX side we do not have any major CAPEX lined up. Small CAPEX is about Rs. 3-5 crore is what we are incurring this year, and this could be the amount next year, i.e Rs. 5-7 crore and not more than that.

Sachin Kasera: So do we see a substantial reduction in interest cost in FY19 or FY18?

Pradeep Rustagi: FY19 should be significantly let us say it could be about Rs. 3 crore a year because Rs. 43 crore is to be repaid, its average would be about six months, so at 10% close to Rs. 2.5-3 crore.

Sachin Kasera: But do not you see any with the debt being repaid any improvement in terms of ratings and hence the lower rate of interest that we are being charged?

Pradeep Rustagi: That can happen. But nowadays the banks fix the rate of interest for one year that is the problem. It is not directly linked. It cannot change, as soon as you improve the rating the rate will be changed in the next renewal.

Moderator: We will take the next question from the line of Avinash Gorakshakar from Joindre Capital Services Limited. Please go ahead.

Avinash Gorakshakar: Just wanted to know that I think in terms of the specialty polymer business and engineering plastic business what kind of outlook can you give us for the next say 2-3 years. How big is this market? In fact, any market size or what kind of growth numbers if the management can actually clarify.

Arvind Singhania: See as far as the engineering plastic business is concerned, we can expect growth of about 8% to 10% per annum for the next 2-3 years. As far as the specialty polymer business is concerned, I have already given my number that we will do about Rs. 45-50 crore in the current financial which has a possibility to grow to about Rs. 80-100 crore in the next year.

Pradeep Rustagi: In engineering plastic the industry growth rate is about 6%. We expect to outperform the industry growth rate.

Avinash Gorakshakar: Just one more additional question, your EBITDA margins have shown a good improvement in the first half, 6.8-8% I mean in terms of margin outlook can we expect that the second half is also equally good like you know in terms of the operational performance EBITDA has moved up quite commendably. Can we expect that now since the GST normalization has happened, the second half is definitely better and obviously FY19 also should look a lot better on the EBITDA margin front?

Arvind Singhania: Like I said FY19 will definitely look better. Engineering plastics is going to take another couple of quarters to come back to normalcy because the effect of GST is longer in that especially in the electrical and electronic segment. Film has come back substantially already and we expect film to be quite stable for the next couple of quarters. In fact, we might see some improvements starting on the fourth quarter, last quarter starting January.

Avinash Gorakshakar: Do you have any tax break which can give you a little bit of tax shield once you actually start making money at the PBT level because we just wanted to know is there any kind of tax break or any accumulated loss which you have, which you can adjust going forward?

Pradeep Rustagi: In the income tax yes, we have some certain accumulated losses which will be first adjusted before we start paying tax.

Avinash Gorakshakar: So this will be reflected when, I mean FY19 also should be a year where possibly tax will be relatively less?

Pradeep Rustagi: Now the problem is that from the tax we paid the MAT which is about 20% and the tax rate is only 30%. So from cash flow there would not be any major improvement because of the tax ratings but as an expense, yes, even if we make profit there would not be any tax liability as far as the expense is concerned.

Avinash Gorakshakar: So basically I just wanted to clear the provision for tax when we see it on the financial number what will the effective tax rate be, if you can please clarify?

Pradeep Rustagi: Effective tax rate is always 33% because of the deferred tax liability. Because of the book losses and the income tax losses there is a deferred tax asset or liability created. So the effective rate as far as the P&L is concerned it is always about 33%It is just that when you start making real profits, the tax outgo would be restricted to 20% on account of MAT. We may not end up paying 33% as regular tax because that are brought forward losses in the income tax.

Moderator: As there are no further questions I now hand the conference over to the management for their closing comments.

Arvind Singhania: Thank you very much for joining in on the earnings call for Ester Industries. Thank you everyone.