Ester Industries Limited

Q2FY24Earnings Conference Call Transcript

November 9, 2023

Moderator: Ladies and gentlemen, Good day and welcome to Ester Industries Limited Q2 FY24 Earnings Conference Call.

Please note that this conference is being recorded.

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 a warm welcome to Ester Industries Q2 &H1 FY24 Analyst and Investor Conference Call.

We have with us day Mr. Arvind Singhania – the Chairman and CEO, Mr. Pradeep Kumar Rustagi – the Executive Director- Corporate Affairs and Mr. Girish Behal – Business Head.

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 some statements made in today's discussion may be forward-looking in nature and a note to this effect was shared with you in the invite earlier. We trust you have had a chance to go through the financial performance.

I would now like to hand over to Arvind Singhania to make his opening remarks. Over to you, Arvind.

Arvind Singhania: Thank you, Gavin and thank you everyone for joining us today. I have alongside with me Mr. Pradeep Rustagi – Executive Director-Corporate Affairs and Mr. Girish Behal -- Business Head Film SBU

I will briefly talk about the key Business Highlights, post which Pradeep will walk you through our “Financial Performance”.

The current business landscape continues to pose challenges for both BOPET Films and the specialty polymer sectors.

On a standalone basis, though the quarterly performance reflects improvement on a sequential basis at a broad level, it does mirror the pressures being faced by both these industries. We have seen our industry peers in the BOPET Film business report subdued performance in the same period as well.

Starting with the BOPET Film sector and we have been emphasizing the significant increase in supply due to the introduction of new capacities, this surge in supply has negatively impacted pricing margins at overall profitability.

On the other hand, the Specialty Polymers division safeguarded by intellectual property rights is not exposed to direct competitive risk, but it is nonetheless exposed to the challenges of a slowdown and the uncertainties grappling the U.S economy which is its primary market.

Let me now move on to our quarterly performance. To start with the headline numbers on a standalone basis, our revenue for the quarter stood at Rs. 244 crore with EBITDA of Rs. 3 crore and a loss for the quarter at Rs. 13 crore. The underwhelming performance as previously highlighted mirrors the on the ground hurdles our businesses are currently facing.

The film business, as we have previously mentioned, is experiencing acute demand supply and balance due to commissioning of new capacities. This combined with the subdued demand in overseas markets has negatively affected the profit margins. The performance of the specialty polymers business has also been affected by continuing recessionary pressure in the US, which is key and major market for this business.

Moving on to individual businesses now, starting with specialty polymer. While we did witness some improvement in both revenues and volumes during the quarter compared to Q1, the on-ground situation though remains challenging owing to the uncertainties and inflationary worries grappling the US economy.

In terms of product offtake, we have seen 14% growth in volumes on a sequential basis, although on a year-on-year basis it has degrown. The present volume trajectory is below the historical averages and the true potential of the business. During Q2 as well despite reporting higher volume, we have seen our profitability and margins trend lower owing to lower contributions from the marquee higher margin products.

MB03 volumes for the quarter stood at 179 metric tons has again 422 metric tons in Q2 FY23 and 247 metric tons in Q1 FY24. As far as innovative PBT is concerned, Q2 witness volumes of 185 metric tons as against 605 metric terms in Q2 FY23 and 79 metric tons in Q1 FY24. We have been reiterating that the products and the businesses on its own is not subject to competitive threats, given that most of our products are IP protected.

The growth momentum though is subject to the overall business sentiment and health of the US economy. We are hopeful that the demand and subsequently the volumes and profitability of the business will revise maybe after a couple of quarters as the US economy starts to recover.

It is important to mention here that basis revenues of Rs.130 crore of specialty polymer SPU generated during half one of FY23 we have achieved annual run rate of about Rs. 260 crore. With EBITDA of approximately Rs.85 crore, as soon as global and U.S. economy revive, we are confident of bettering these numbers. We are committed to harnessing our R&D expertise to infuse innovative and captivating products.

We maintain a positive outlook on the business potential in the medium-to-long term and have the confidence to navigate to the current short-term challenges.

Turning attention to our Film business as we are emphasized in our prior discussions, there has been an influx of excess capacity in the market due to commissioning of new production units.

Most of the production lines that got commissioned in the recent past were put under implementation after we started implementation of Telangana project in October 2020. While the growth in demand continues to be robust with domestic demand growing at 11% to 12% per annum and global demand growing at 5.5% to 6% per annum, the supply has surpassed the demand by significant percentage leading to a chain reaction of reduced pricing and margins.

This along with subdued demand and export markets aggregated by geopolitical. disturbances across the world have further exacerbated the pricing challenges. Our overall volumes for the quarter stood at 18,867 metric tons comprising of 12,892 metric tons on a standalone basis and 5,975 metric tons at a subsidiary level. Despite higher volume growth though we have seen moderation in profitability and margins during the quarter owing to the sharp price and margin erosion.

We believe the pricing pressure will continue for a couple of quarters before the stabilization process starts. Our efforts till then will be directed towards enhancing efficiencies and improving product mix by increasing the share of value-added products.

On a standalone level, we have seen our share of value-added products comprising 25% during the quarter. We are also working on new products that will enable us to improve profitability and mitigate the effect of a network market scenario. We are also focusing a lot on reducing cost, reducing wastages and improving efficiencies.

We believe such efforts will help us deliver stable and profitable performance in the long term. That concludes my opening remarks. I will now hand over the floor to Pradeep to walk you through our financial performance. Thank you.

Pradeep Rustagi: Thank you and good day, everyone. Thank you for joining us on our Q2 FY24 Earnings Call.

Let me quickly walk you through our financial performance post which we can commence the Q&A session. Starting with the revenues on a standalone basis the same stood at Rs. 244 crore as against Rs. 308 crore in the corresponding quarter last year, lower by 21%.

The reason for the degrowth as mentioned by Arvind ji pertains to excess supply in film business and recessionary worries in US, the key market for our specialty polymer business. EBITDA for the quarter stood at Rs. 3 crore as against Rs. 30 crore generated in Q2 FY23 lower by 91%.

Lower realizations in margins in the film business coupled with adverse product mix for the quarter in Specialty polymer business led to lower profitability and margin for the quarter. Loss for the quarter stood at Rs. 13 crore as against profit of Rs. 8 crore garnered in Q2 FY23. Lower offtake coupled with weaker realization/ margin resulted in loss for the quarter.

Moving on to the performance of Ester Filmtech Limited our wholly owned subsidiary. Revenues for the same stood at Rs. 64 crore with EBITDA loss of Rs. 3 crore for the quarter. In terms of volume Q2 FY24 generated 5,975 metric ton as against 5,760 metric tons volume generated in previous quarter. EBITDA losses are largely owing to lower utilization level and the stress in the film business prevailing currently.

With time, we are confident that the Ester Filmtech will contribute positively to the overall growth of the business due to its low operating cost. As mentioned previously, the plant is expected to generate revenue worth Rs. 500 to Rs. 550 crore upon achieving optimal utilization.

In summary, we would like to reaffirm that although the immediate future present challenges for both our businesses, we maintain an optimistic and confident stance. We are returning to overcome these obstacles and propel our business to their full potential in the medium-to-long term, that concludes my opening remarks. We can now commence the Q&A session.

Moderator: Thank you very much. Our first question is from the line of Saket Kapoor from Kapoor and Co.

Saket Kapoor: Sir, firstly thank you for the opening remark that was very vivid and covered a lot of the aspects about the business part, but sir, if we take into account the cycle in which we are currently we must have faced this kind of excess capacity earlier also. If you could guide us, where are we in midst of the glut and then again the demand rising and again we returning to our normal margin situation.

So, are we in midway or is the worse still there in terms of the pricing part and the lower utilization levels which would definitely happen as all players are bleeding and also new capacity. I think one new line is also expected going ahead. If you could give some color on what are the other capacity addition we are seeing in the near future, your outlook, where are we in terms of the pricing?

Arvind Singhania: In terms of the pricing, we are at the bottom, we can't go any further, I mean, at least, substantially further. We are I would say, more than midway through the cycle. We have only one more line left to be commissioned which will be commissioned by the end of this month or early next month, and I think we should start seeing some improvement in the next couple of quarters definitely.

Please also know one very important thing that as per the new plastic waste management rules which have been declared, they demand 10% recycled content in all packaging material. Now this is possible, and this is becoming effective from 1st of April 2025. Now this is possible only with polyester film. It is not possible in BOPP.

So, actually we are going to see a much higher growth in demand starting towards end of next calendar to fulfill this requirement of the plastic waste management rules. Polyester film demand is expected to grow substantially more than any other competitive product.

So, actually we are now I think in the next couple of quarters we should start seeing some improvement in terms of margin and I think by 2025 we will be in reasonably good shape. I hope this answers your question Saket ji.

Saket Kapoor: Yes, sir. And sir for this specialty polymer, I think so things are looking in an even line in if we take quarter-on-quarter numbers, so therein also when can we go back to our previous margin state and the outlook which we had earlier in terms of the offtake?

Arvind Singhania: This is just bad luck Saket ji, please understand that if you take our Q1 numbers of FY23, we reached an annual run rate of Rs.260 crore of turnover with an EBITDA margin of Rs.85 crore, Rs.90 crore. Now this would have actually grown from there had this global recession had not occurred, interest rates have gone up in America from 0% to 5%. And this is hurting the business and economy tremendously and as soon as this recovery starts, which we are expecting, we are expecting this recovery to start by 2nd Quarter calendar 2024. And I am very hopeful that towards the end of next year, we should be coming back to the numbers of last year. This is our expectation.

Saket Kapoor: And sir Rustagi ji if you could give me some color on the how the raw material prices have cleared up and what the current trend there and also on the net debt numbers and I think now with these utilization level also on the utilization levels, if you could just separately the utilization levels for our new facility and the existing one the previous facility?

Pradeep Rustagi: Raw material is more or less is stable the PTA prices are about Rs. 77 kg and the MEG is in the range of Rs. 46 kg which gives us the chip rate raw material cost per chip at about Rs. 81 to Rs. 82 kg. More or less the raw materials have been stable for the last two to three months and we don't foresee any major variation in the raw material cost going forward.

Coming to the debt portion, we have a term debt of about Rs.400 crore outstanding in Ester Filmtech and a working capital outstanding of about Rs.50 crore. So, that's Rs.450 crore in Ester Filmtech and we have close to Rs.300 crore debt Rs.200 is the term debt and Rs.100 crore is the working capital. That's the debt interest bearing debt in Ester Industries. So, all put together both the companies the consolidated debt is Rs.750 crore, but we also have Rs.140 crore lying in the liquid financial instruments security. So, net debt is about Rs.610 crore.

Coming to the capacity utilization, the capacity utilization in Ester Filmtech is about 55% to 60%, whereas in Ester Industries it is 75% plus as far as film is concerned, specialty polymer because of the recession in US, the utilization levels are very low less than 10% currently. So. I hope this answers all the three questions that you had raised.

Saket Kapoor: Yes, sir and the cost of funds, sir, currently?

Pradeep Rustagi: Cost of fund in Ester Industry it is about 10% now because there has been continuous increase in the repo rates, and which is also forcing banks to increase their rate of interest. In Ester Filmtech it is about 7.5% to 8%.

Saket Kapoor: Just taking into account the deterioration in the financial operation and the financial performance. How are we going to ride through this Rs. 600 crore debt on a consolidated basis also it's a large number I am taking into account the current. business environment. What steps are you taking to tide over this and how are the rating agencies taking into consideration the current environment?

Pradeep Rustagi: So, we had a meeting with the rating agency in the recent past and looking at the comfortable liquidity position they are not taking any negative view on the company per se, but in three months to six months' time they would be looking at the industry in totality and then they may come out with some sort of correction if required, but this is our discussion with the rating agency as of now, there is no risk to the downgrade of the rating that we have obtained. We are A minus as of now from CRISIL.

Arvind Singhania: And we have enough liquidity to write through this downturn, so we are not really worried and we are always there to stand by with the company. We have performed extremely well in the last 3 years, 4 years handed out very, very handsome dividends to the shareholders. The share price also went up, unfortunately, because of the excess capacity and the global recessionary conditions this has happened, but this is a very short-term phenomena and we are very, very sure that we will come out with very soon and stronger.

Moderator: Thank you, our next question is from the line of Ajinkya Jadhav from Dolat Capital. Please go ahead

Ajinkya Jadhav: So, I was saying, what are the sectors one must look at to see the signs of potential growth revival for Films business?

Arvind Singhania: What sectors should we look at? Polyester film actually addresses the flexible packaging business, while the specialty polymer addresses many sectors across the board, including consumer electronics, carpets, textiles, industrial rigid packaging, flexible packaging.

So, we are we are actually addressing the host of applications in specialty polymer while polyester film addresses largely flexible packages,

Pradeep Rustagi: And the flexible packaging would be mainly consumer FMCG sector.

Ajinkya Jadhav: So, my question is MB03 and innovative PBT these two products how much they contribute to the specialty polymer business?

Arvind Singhania: They contribute very largely to the specialty polymers business, about 70% to 80% and right now because of the like I explained, because of the recession in the U.S and global recession actually the volumes have fallen quite substantially and we are hoping that this will start reviving by middle of next year, by the middle of next calendar.

Ajinkya Jadhav: Just last question from my end, like how is the pipeline in this specialty polymers business for the new products? Are there any plans to launch?

Arvind Singhania: The pipeline is quite strong and actually we are working on a couple of very interesting products right now and we are very hopeful that they will also start giving dividends. It may take some time because we have just started introducing it to the market. So, hopefully by sometime during next year, we should hear some positive if we get start getting positive effects of it also.

Moderator: Thank you, our next question is from the line of Jatin Damania from Svan Investment Managers.

Jatin Damania: Sir, just wanted to understand more from an industry perspective now I mean you mentioned in the opening remarks that there was an oversupply and probably we are at the mid level of cycles and there's only one more line coming up in the coming month, but if you look overall, the industry, there are number of players are increasing our capacity. So, if you look in, I mean almost 58% capacity, we have seen an increase over December 21 in BOPET and similarly 23% in the BOPP and almost two third of the capacity is another lined up in March 2026. So, over a longer period of time how shall one look at the BOPET and BOPP Industries and the spread going ahead?

Arvind Singhania: See, it's all a question of demand and supply. Right now, the supply is much more than demand, that is the reason why the margins are under compression, but the good news is that the demand growth is extremely positive, and it is growing at about 10% to 12% domestically and about 6% globally. So, this will lead to closing the gap between demand and supply very soon. So. let's say right now if you're at about 65%, 67% capacity utilization, the moment we start touching anything between 75% to 80%, we start seeing improvement in margins. So, it's wouldn't not be too far away before we start seeing improvement. Like I said, in a couple of quarters we will start seeing improvement and this is what we are strongly see.

Jatin Damania: So, which segment is driving that growth and probably you are still being so confident that in couple of quarters we'll reach to a 75%. So, can you help us with segment which will drive the overall growth?

Arvind Singhania: All segments across the board FMCG this goes for flexible packaging of dozens of FMCG products including rice, sugar, salt, tea, coffee, namkeen biggest sector is Namkeen your Bhujiya and your big brand names, snack foods, potato chips, everything is packaged in polyester and BOPP and these sectors are growing phenomenally. I mean these numbers are available for you to see on public platforms. So, when these sectors grow so phenomenally, the growth of the packaging is bound to grow in a similar manner.

Jatin Damania: Right, also, in your opening remarks or probably in the previous comments, you also indicated about the new plastic policy that will probably come into effect from first April of 25. So, on a ballpark number, do we have any ideas what would be the incremental demand that we will probably generate from this policy?

Arvind Singhania: Well, the policy says that all flexible packaging must contain 10% recycled content. And this is effective from 1st of April 2025. Now, polyester is the only product which can meet this requirement even BOPP do not meet this requirement of a 10% recycled content. So, I believe, or we believe that there will be a big switchover from BOPP towards polyester once this becomes effective. It's very difficult to give numbers, but I would imagine there will be a substantial boost to the consumption of polyester film.

Jatin Damania: And so coming to your quarterly numbers because compared to last quarter we had some impact of the shutdown at our facility in Telangana. So, if you can help us the status, what was the status of the entire facility in Q2 because that capacity which came on strain and at what level we utilize this?

Arvind Singhania: About 65% the Telangana is at 65% capacity utilization.

Jatin Damania: And the last question, which is on the specialty polymer, so because we are seeing the near-term headwind because we are seeing a decline in the demand. So, by any chance are we seeing any green shoots or probably two or three quarters down the line or probably are we getting anything from the US end customer that probably we are seeing a revival in demand because that's the key product and which will drive the overall value-added proposition in our entire basket and drive the margin. So, if one want to understand the growth in this facility polymers and the margin probably for FY25-26. So, how should one we should look at it?

Arvind Singhania: I think by FY if you talk about FY26 or let's say the year of '25-26 I think we should be fully back to normal baggage.

Jatin Damania: So, is it safe to assume that you will be around 25% 30% for the Specialty polymer at that point of time?

Arvind Singhania: So, like I said, I expect the revival of specialty polymers to start sometime middle of next calendar around June, July or May, June. And by the end of next calendar, that means by end by December '24 or let's say early 2025, we expect most of the demand to come back in specialty polymers. So, '25-26 should be a very good year for specialty polymers.

Moderator: Thank you, our next question is from the line of Saket Kapoor from Kapoor and Co.

Saket Kapoor: Sir, I was looking for an answer for the new capacity that will be commercialized in the near future, domestically also and internationally also the size?

Arvind Singhania: I think as far as the domestic is concerned, there's only one line coming up this year and one is coming towards end of next year. That's all. And there is nothing else stated till '26 or '27.

Saket Kapoor: And internationally, sir?

Arvind Singhania: Internationally, there is no capacity that we know of other than China, where some where some substantial expansions are taking place, but to get absolutely accurate information out of China is very, very difficult and they don't export anything, it's not really a threat to us.

Saket Kapoor: And sir taking into consideration the current domestic demand? Are films being imported in the country?

Arvind Singhania: No, there are no imports. There is no import threat as of now.

Saket Kapoor: So, what factors will change our fortunes going ahead, how will these capacities get absorbed and how is the path going to be, what's your experience?

Arvind Singhania: Very simple Saket ji I have explained before demand growth is about 11%, 12% in India is 6% globally and once we the plastic waste management rules become effective 1st of April '25, the demand for polyester film will suit even more. There is likely to be convergent from BOPP to polyester film because BOPP cannot offer products with 10% recycled content only polyester can. So, we expect demand to do substantially in the polyester sector starting April '25.

Saket Kapoor: And sir how has been our performance in the value-added segment I think so for Ester Limited we had a good proportionate and we also guided for?

Arvind Singhania: We are doing quite well. They're doing quite well and in fact we are working on one very interesting product which could actually become a game changer for the whole flexible packaging industry. You will come to know of that very soon.

Saket Kapoor: That is again in the value-added segment only?

Arvind Singhania: It is a value-added product, yes.

Saket Kapoor: And what are the spreads currently I forgot to ask. Currently, per KG spread for us?

Arvind Singhania: Domestic market would be around Rs. 17 to Rs. 19.

Saket Kapoor: And in optimum conditions sir what are the reasonable margins that we have been incurring over a period of time consistently for giving away the variation?

Arvind Singhania: We have see crazy margins of up to Rs. 75 that of course is not going to come back for a while, but I would imagine reasonable margins to be in the region of about Rs. 40 to Rs. 45. I think that we should expect to see this kind of future.

Moderator: Thank you. Ladies and gentlemen, that was the last question of our question and answer session. As there are no further questions, I would now like to end the conference over to the management for closing comments.

Arvind Singhania: Thank you all for attending the earnings call today and I look forward to seeing you all for the next earnings call for the Quarter 3. Thank you very much and have a good day.

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