PPAP AUTOMOTIVE LIMITED

"PPAP Automotive Limited Q4 and Annual Results FY18 Conference Call"

Transcript

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MANAGEMENT: MR. ABHISHEK JAIN – CHIEF EXECUTIVE OFFICER AND MANAGING DIRECTOR
MR. MANISH DHARIWAL – CHIEF FINANCIAL OFFICER

Moderator: Good evening ladies and gentlemen. Welcome to the conference call of PPAP Automotive Limited arranged by Concept Investor Relations to discuss its Q4&FY18 results. We have with us today Mr. Abhishek Jain – CEO and Managing Director and Mr. Manish Dhariwal – CFO. Please note that this conference is being recorded. I would now like to hand the floor over to Mr. Abhishek Jain. Thank you and over to you sir.

Abhishek Jain: Thank you Zaid. Ladies and gentlemen, a very good evening to all of you. Thank you for joining us to discuss the operating and financial results for the Q4 of FY 18 and the full year ended 31 March, 2018. I will begin with a brief about the company and we will then look forward to taking your questions and suggestions. The company's Chief Financial Officer, Mr. Manish Dhariwal is also joining us on this call.

Abhishek Jain: PPAP manufactures polymer extrusion based automotive sealing systems, interior and exterior automotive injection molded products in India. We started the production by supplying automotive parts to Maruti, in the Indian market in 1985. Today we manufacture over 500 different SKUs and ship over 1,50,000 parts every day to our customers who are located pan India, targeting a zero defect in quality and delivery. Some of the largest OEMs in India like Maruti, Honda, Nissan, Toyota, Tata, GM, Ford and Mahindra are our customers. Most of you would be aware we recently started supplying to Hyundai for their Eon model. I am glad to share with you that we have added another customer to our supply list- MG Motors India. If you recall, MG Motors is a British car manufacturer, which is now owned by China-based SAIC Corporation, the largest auto manufacturer in China and will soon begin selling its cars in India. MG Motors will be launching one new product every year, beginning 2019. The company has already taken over General Motors plant in Halol.

While we primarily service the passenger car segment, we have also started supplying to the LCV and the two-wheeler segments. In the LCV segment we have SML ISUZU and Bharat Benz as our customers. In two-wheeler segment our customers are Suzuki motorcycles and Honda motorcycles. 10% of our automotive sealing products are exported by our customers as part of their CKD kits to countries like Japan, Europe, Mexico, Venezuela and others.

Our company is led by Mr. Ajay Kumar Jain who is the Chairman and the Managing Director. He continues to be the President of the Toyota suppliers Association as well as a Director of ACMA. I am an industrial engineer and have been a part of PPAP for the past 14 years. Today we can proudly say PPAP is widely spread across northern, western and southern India. Our company's state of the art manufacturing facilities are located in Noida and Surajpur in Uttar Pradesh, Chennai in Tamil Nadu, Pathredi in Rajasthan and Viramgam in Gujarat. Our Greenfield project in the key auto hub Gujarat is successfully supplying to the blockbuster new Swift model at the Suzuki motors Gujarat facility, while the newly setup Chennai plant caters mainly to Renault Nissan. Our Brown field expansion in Pathredi has also been completed.

In 2012 we established an equal equity joint venture company- PPAP Tokai India Rubber Private Limited, which is called as PTI with our Japanese technology group partner Tokai Kogyo. With this in place now PPAP and PTI cater to the consolidated requirements of sealing systems for its customers, giving the company a strategic advantage of being a one stop shop for sealing systems. The joint venture has shown a growth of 33.4% in FY18. Our other technical collaboration is with Nissan Chemitec, Japan for injection molded products.

We are continuing on our journey of ‘Built in Quality’ to achieve high standards of product quality, as well as, cost optimization with a focus on R&D, robust product portfolio with strong brand and technical partnership with international players. The company is on track to establish its presence in all the major automotive clusters in India, to improve proximity to the customer. We are extensively exploring all strategies which meet our objective of achieving profitable growth. In that direction we are quite open to examine any inorganic opportunity in order to de-risk our revenues by technical collaboration and joint ventures. We are very happy to note that the business in Suzuki motorcycles established with the same motives is growing. We started with one model and now we are already working on their second model. We have been choosy in the kind of business that we are taking on, while we de-risk our business the protection of our margins is our priority.

To give you a brief overview of the industry, the domestic passenger vehicle segment has seen a 7.9% year on year sales growth in FY18. A total of 3.29 million passenger vehicles were sold in the domestic market, against 3.05 million last year and 0.75 million vehicles were exported. The industry produced 4.01 million cars, which is an increase of 5.5% year on year, according to the official SIAM figures. The commercial vehicles production saw a growth of 10.4%, whereas the two-wheeler production was at 23.15 million, which is an increase of 16.1% year-on-year. In FY19, the passenger vehicles are expected to grow at 7-9% on the back of continuing rural demand.

Now I would like to take you through the financial performance for the quarter under review. The detailed slides have already been shared with you. I will request you to kindly refer to them. Consequent to the introduction of GST, with the effect from 1st July, 2017 Central excise, VAT, etc. have been subsumed into GST. In accordance with the Ind AS 18 on revenue and Schedule 3 of the Companies Act, 2013 unlike excise duty, GST, VAT etc. are not part of the revenues. Consequently, the revenue figures of March 2017 quarter include the excise duty whereas March 2018 figure is net of GST. For Q4 ended March 31, PPAP recorded a total income of Rs. 127.6 crore as compared to Rs. 96.2 crore in the corresponding quarter of the last year, registering a growth of 32.7%. Part sales amounted to Rs. 96.6 crore whereas tool sales contributed Rs. 30.9 crore.

EBITDA grew by a healthy 40.2% in Q4 and was at Rs. 28.7 crore compared to Rs. 20.5 crore in the previous year. Sequentially, the EBITDA was up by 48.9% compared to Rs. 19.3 crore in the previous quarter of this financial year. The company's EBITDA margin has been improving consistently and stood at a robust 22.5% in the quarter, compared to 21.3% in the same quarter previous year and 21.3% in the Q3FY18. The rise in EBITDA is primarily due to the constant efforts of the company in achieving excellence across all the various facets of the organization.

Profit after tax recorded a jump of 63.8% year-on-year and stood at a robust Rs. 14.09 crore in the quarter compared to Rs. 8.6 crore in the same quarter last year and Rs. 8.2 crore in the previous quarter of the current year. The company recorded a PAT margin of 11.04% in the quarter compared to 8.94% in the same quarter previous year and 9.0% in the previous quarter of the current year. The EPS for the quarter stands at Rs. 10.06 which is an increase of 63.8% compared to Rs. 6.15 in the last year. Our return ratios have shown significant improvement now with ROCE for the quarter being at 30% compared to 20% a year ago.

Now I will present you the full year, standalone financial results. The total income for the financial year stood at Rs. 397.6 crore which is up by 15.3% compared to Rs. 345 crore in the previous year. EBITDA stood at Rs. 84.9 crore compared to Rs. 66.6 crore in the previous year, which is up by 27.4%. We recorded an EBITDA margin of 21.4% compared to 19.3% in the previous year. The net profit stood at Rs. 37.4 crore which is an increase of 49.3 % compared to the previous year. Our PAT margins have improved from 7.3% to 9.4%.

The EPS for the year stands at Rs. 26.72 which is an increase of 49.3% compared to the EPS of Rs. 17.90 recorded last year. For the full financial year under review the ROCE stands at 20.5% compared to 15.2% recorded in the previous financial year. Our ROE for the year stood at 13.9%, with the capacity utilization at around 75-80%. We have enough headroom for expanding our sales without any major capital expenditure. CAPEX for FY18 stood at Rs. 50.75 crore. Barring the ongoing projects and maintenance CAPEX there should be no major requirements in the year, going forward. All the CAPEX requirements for the year 2018 were met by our internal accruals and we expect the trend to continue in future as well.

Our debt equity ratio stands at 0.11 with a repayment of Rs. 14 core of the existing loan in FY18. I am happy to share with you that the Board of Directors reviewed the performance of the company in the Board meeting held on 21st May, 2018 and have decide to recommend a final dividend of Rs. 2.50 per share, thereby taking the total dividend for the financial year to Rs. 4.5 per share which is 45% of the face value and an increase of 50% compared to the dividend declared in the previous year. The dividend payout ratio including all the taxes comes out to be 20%.

Now I will give you a brief about the performance of our joint venture company PTI. The total income of that company stood at Rs. 63 crore which is up by 33.4% compared to Rs. 47.2 crore in the previous year. We are continuing our trend of having a higher growth compared to the industry growth. The EBITDA stood at Rs. 6.2 crore in the 12 months compared to Rs. 8.2 crore in the previous year. We recorded an EBITDA margin of 10% in the 12 months. The cost profile went up due to additional infrastructure of new plant and the new product trials that were required to launch the new products that have been made by our joint venture company. The PAT stood at Rs. 3.8 crore against Rs. 5.8 crore in the previous year and we recorded a PAT margin of 6% in that company.

Now I will take you through the consolidated numbers. The company has consolidated its joint venture by equity method in accordance with the Ind AS 28-Investment in associates and joint ventures. PPAP's share of joint-venture profits and OCI is included in the consolidated profit and loss statements. Accordingly the change in the value of the investment in JV is reflected in the consolidated balance sheet. The net profit on a consolidated basis stood at Rs. 39.3 crore which is up by 40.6% compared to Rs. 28 crore in the previous year. PAT margins have improved from 8.1% to 9.9% and the consolidated EPS stood at Rs. 28.08 against Rs. 19.97 in the previous year.

I am glad to announce that we have been appreciated by our customers for our superior performance in the previous year. We have won award from Toyota and Maruti for our overall performance. From Toyota we have received 'Supplier of the Year' Award, which is The Gold Award given to the best performing supplier of the year. We have also received the 'Overall Performance Shield' from Maruti which is given to the top 15 suppliers of Maruti. Apart from these our efforts for quality, manufacturing and delivery has also been recognized with 'Zero PPM Award-' Certificate for achieving quality targets and the delivery targets by Toyota. Hyundai has also appreciated our efforts in supporting their localization efforts. PTI the joint-venture company has also been awarded by Toyota and Maruti this year.

This brings me to the end of my introduction, now I would like to leave the floor open for questions and suggestions that you have. Mr. Dhariwal and I will try our best to answer all of them.

Moderator: Thank you very much sir. Ladies and gentlemen, we will now begin with the question and answer session. The first question is from the line of Viraj Kacharia from Securities Investment Management. Please go ahead.

Viraj Kacharia: Can you give us the part sales for similar quarter last year?

Manish Dhariwal: Part sales for the March, 2017 quarter was Rs. 87.37 crore and the tool sales was Rs. 7.16 crore, totaling to Rs. 96.2 crore, for March, 2018part sales is Rs. 96.6 crore and tool sales is Rs. 30.9 crore.

Viraj Kacharia: So if we look at our overall part sales for this quarter the year-on-year growth is only 11% so bulk of the growth has come from tool sales. The key products and the platforms which we are for Maruti, Honda, and now starting to cater to Eon but physically the overall growth rate seems to be relatively lower so I just wanted to understand why is that?

Manish Dhariwal: See during the call we mentioned that the industry growth has been at 5.5% for the whole year.

Viraj Kacharia: Sure but if we look at the key models and the platforms which we are at, a growth rate say we talked about Baleno and Brezza and the likes that the growth rate is in high double digits even in Q4 so just wanted to understand where is the difference?

Manish Dhariwal: We are supplying those models as well, but we are supplying to many more models and customers also. So when you are doing the aggregate, then in totality the growth that you get, is what we have shown.

Viraj Kacharia: Second question is if you can provide any further updates in terms of Hyundai, as you also spoke about us starting to cater to Creta and other models. So if you can provide any updates as to where we are and how much of the revenue or the growth would have come from Hyundai in this quarter?

Abhishek Jain: This was the first quarter where we started supplying to Hyundai. Currently Hyundai contributes less than 1% to our top line. But going forward we are expecting this to become at least 3-4% of the revenues.

Viraj Kacharia: This is purely from Eon alone right?

Abhishek Jain: We have started Eon right now and we are developing parts for 2 other models, which will be introduced this year.

Viraj Kacharia: So what will be our typical wallet share there, since we just started how much we would be catering to Eon alone?

Abhishek Jain: Eon whatever product we are making we will be the single source for it. We will be present in 3 models by the end of this year going forward.

Viraj Kacharia: Next question was on the CAPEX side, you said we won't be entering any further CAPEX so what will be your plans for FY 2019-2020?

Abhishek Jain: We will still be incurring some sort of CAPEX this year because we need to have some idea for maintenance CAPEX as well. But most of our CAPEX is already complete in previous year, in FY18.

Viraj Kacharia: Okay so how much?

Abhishek Jain: Probably it will be in the range of Rs. 25–Rs.30 crore. But again all this is tied with the customer. So this is just a ballpark estimate that we have done and everything will depend on what business we get throughout the year and in case if we get some additional business then this value will obviously vary according to that.

Viraj Kacharia: You spoke about us being open to potential JVs and tech collaboration or even inorganic opportunity, so if you can elaborate a bit more on what is the broader thought process, is it within the existing space or somewhere we have not stepped in?

Abhishek Jain: No. Primarily whatever opportunities for growth, we are scouting are going to be in the existing product domains, that we are present in. So our effort is to continuously expand our existing products to all the customers which are present in India and then find out new opportunities for similar kind of products with them. So basically our target is that we will be increasing our per car business to all the OEMs in India, either through expansion of our product range or through signing up with new customers.

Viraj Kacharia: Andon the margin side, we have seen continued strong expansion in operating margins. But if we look at the overall mix, there is some reclassification probably in terms of, as our gross margin as it is sequentially declining and we have seen a sharp reduction in the other expenses as well. So just wanted to understand, has there been any reclassification per say?

Manish Dhariwal: There were two things that had happened; one that these numbers are as per the Ind AS requirements and two, the reclassification for correct representation of data is basically in process. So in specific, I would like to share that, earlier there was some outsourcing work that was getting done, which was getting added onto the parts was basically being shown as other expense. But actually that was part of the raw material cost. So therefore we have corrected that and now it is a part of the raw material cost.

Moderator: Thank you. The next question is from the line of Suvarna Joshi from Axis Securities. Please go ahead.

Suvarna Joshi: Thank you for the opportunity and congratulations on the good set of numbers. I have two questions; one is taking forward the question regarding the gross margin and the EBITDA margin as the earlier participant also alluded to. So if we see sequentially and on a year-on-year basis we find that our gross margins have actually contracted quiet significantly. How much of that is owing to the reclassification of the outsourced expense coming into raw material and how much of it is to do with the raw material cost increases, because we have not seen a mix change happen quite significantly for us to have reported very strong EBITDA margin. So just wanted to understand if I'm missing something over there?

Manish Dhariwal: If you could observe that tools, which are contributing a significant percentage to the turnover, have an element of outsourced tools as well. So when you are buying a tool and then supplying it to the customer, then the cost of that tool is reflected in the material cost.

Suvarna Joshi: Sure, but would you be able to quantify as to how much of that would be this particular cost, in the overall raw material cost that we have reported about Rs. 71 odd crore?

Manish Dhariwal: Our material cost for the parts is continuing in the same trajectory of sub-50%. There has been no change in the raw material cost in the parts business. The change that you see is on account of the cost of tools that has got added on to the material cost.

Suvarna Joshi: If you help me with the absolute amount of this raw material costs, specific to tools will be really helpful.

Manish Dhariwal: Yeah, so I can get back to you on this, as it is a very specific question. I can answer that separately.

Suvarna Joshi: My second question was on the EBITDA margins front. So we have already seen 22.5% kind of EBITDA margin in Q4 and for the full year we have clocked about 21.3%. So do we intend to maintain these levels of EBITDA margins or we are looking at probably improving these. If you are looking at improving, what are going to be the levers for that?

Manish Dhariwal: The EBITDA margins of about 20-21% reported for the year are at present looking very achievable and we are fairly confident of maintaining those margins. And we are continuously watching the headwinds that are coming in on account of crude and the currency and so far I am happy to say that not much change has happened. Our raw material cost on account of our continuing efforts like sharing the costs with the customer-which is a pass-through and reducing the material utilization as part of our efficiency efforts will broadly keep the material cost at the same levels. This is our understanding, as of date and we are fairly confident that the EBITDA margins that we have achieved so far should be continuingly achieved.

Suvarna Joshi: So if I understand that correctly you are hinting that we will maintain our level of raw material percentages to the sales, that we are right now at around 51 odd percent.

Manish Dhariwal: Exactly 50-51% will be the raw material cost.

Suvarna Joshi: And the current headwinds that you mentioned on crude and currency, because I understand we have also imported some bit of our raw material, should not affect us in FY19 and going forward.

Manish Dhariwal: So far we are confident that we will be able to manage.

Suvarna Joshi: So could you just help me to understand how much of our raw material was imported?

Manish Dhariwal: It was about 25-27%.

Suvarna Joshi: My next question was on signing of a new customer that you mentioned MG Motors. So could you just throw some more light on that and help us understand as to whatever are plans of the customer the OEM that you have tied up with and how are we going to supply their requirements from, is it going to be from Gujarat or Pathredi or how is that going to be planned out?

Abhishek Jain: Currently MG Motors are planning to launch one model in India so we have got some business from them, which will be primarily serviced by our Gujarat location.

Suvarna Joshi: Is this going to be for the sealing parts or is it going to be more for the injection molded parts?

Abhishek Jain: We are starting with the injection parts right now, but they have shown quite a bit of interest in our sealing systems as well. But initially it will be for the injection parts. We are developing around 11 parts for them.

Suvarna Joshi: And what would be the typical content per car that we would see with this particular OEM?

Abhishek Jain: Currently we have not finalized on that because right now we have got some preliminary drawings only. So this will get revised in due course of time.

Moderator: Thank you. The next question is from the line of Varun Bakshi from Equirus Securities. Please go ahead.

Varun Bakshi: Sir my question is regarding the new plants that are coming up, Gujarat and the Chennai plant, can you just brief us about the status of the Gujarat plant and the ramp up of Chennai?

Abhishek Jain: See in Gujarat we have 2 manufacturing locations; one is our own premises, which is owned by the company and one is the rental premises. So currently we are supplying injection parts from the rental premises for the Swift model. And this year we will be shifting the injection premises from rental plant to our own plant, sometime next month. And then we will also start supplying for the Baleno model from Gujarat plant. Then this year we are also setting up our extrusion facility in the rental premises, which will be vacated by the injection plant and there we will be setting up final assembly operations for the Suzuki motors Gujarat, along with the joint operations for our joint venture company as well. So basically by the end of this year we will be able to support SMG in Gujarat for all our product segments and for all the cars that will be made by them in that area.

Varun Bakshi: What would be our typical revenue guidance from the Gujarat plant? What kind of revenue numbers, we will be looking at?

Manish Dhariwal: The injection business will give us close to Rs. 13-14 crore next year. But this is based on the parts that we have at this moment. There is a dialogue that is continuing for getting some more parts. So this number is expected to go up.

Varun Bakshi: And about Chennai plant?

Abhishek Jain: Currently we are supplying from our Noida plant all the way to Chennai, because our customers are located there. So all those parts will be localized in our Chennai plant so that is our first priority and then new customers like Hyundai and maybe Kia motors in future, will also be serviced by the Chennai plant.

Moderator: Thank you. The next question is a follow-up from the line of Viraj Kacharia from Securities Investment Management. Please go ahead.

Viraj Kacharia: Thank you for the opportunity; I had one query on the JV side. Just wanted to understand how are you looking to scale up JV, say about 2-3 years and what will be your utilization at the moment?

Manish Dhariwal: JV has a pretty healthy trajectory and new model, Yaris that has come up, that has been introduced by Toyota so we are doing parts for that, so there is a continuous buildup of models that is happening and the growth is going to be fairly good.

Viraj Kacharia: So what I meant was for me to understand, the kind of investments that you have made, we can scale up the business up to somewhere close to Rs. 100 crore in terms of top line, post which we will be having to make some further investments in CAPEX and am I right in thinking that way?

Manish Dhariwal: At this point of time, **even** the turn over which is more than Rs. 100 crore would be met by the existing infrastructure that has been created.

Viraj Kacharia: What would be the utilization right now?

Manish Dhariwal: We are very comfortable on the utilization front it would be in the range of about 55-60%. It is not a concern area.

Viraj Kacharia: The margins that we see on the stand-alone business, eventually, we should see similar margin profile in the JV over a period of time, is that right?

Manish Dhariwal: That is the target, absolutely.

Viraj Kacharia: Once we reach somewhere close to full utilization in JV operations, we should be having a similar kind of margins profile which we have in standalone?

Manish Dhariwal: Yeah, absolutely. You are right.

Moderator: Thank you. The next question is from the line of Archit Ranka, an individual investor. Please go ahead.

Archit Ranka: Hi sir my question is regarding the raw material prices**,** the gross margin. So if you see the gross margins have declined significantly, this quarter. So my question is; are you able to pass on your increase in the raw material prices to your customers or you bear it? So this is what I wanted to understand regarding your pricing power.

Manish Dhariwal: Your observation that the gross profit ratio has reduced, and the gross margins have come down because of the higher material cost is basically because there has been a very high level of tool sales that has taken place and significant portion of the tool cost is getting reflected in the material cost itself.

Archit Ranka: Are you able to pass on this cost to your customers or you have to bear that cost? Like incase the raw material prices increase in future like the rubber and all, so, are you able to pass it on or it will be borne by you?

Manish Dhariwal: On the parts side of the business the material cost is expected to remain at the similar level as it was there previously. It will be met, by either passing on the cost to the customer or it will be met by our internal efficiency efforts. So the material cost is expected to remain at the similar levels.

Archit Ranka: Okay one more question is regarding the employee cost. If you see the employee cost is around 15-16%, if you see as the industry as a whole so it is around 10-11%. So why is it that such a high employee cost for your organization, if you can highlight something on it?

Manish Dhariwal: Mr. Ranka you have made a correct observation that our employee cost is on the higher side when you look at it from the industry point of view. See you must appreciate that the nature of our business, and the way we have structured our business, we are a print to build company wherein a whole lot of activities are actually undertaken in-house. To give you an example, for some special purpose machinery that is required for the difficult part that we do, they are actually made in-house. So we have an in-house design shop, an in-house tool making, we have in-house special-purpose machine making setup. Now, because of that, the cost that is spent on our man power is obviously reflected there. Having said this, we have also grown from just being an NCR company to a company which is having a pan India foot print. Now that has also resulted in our employee cost, growing at a rate higher than it could have been. And then you know with the increased profitability, our bonus has gone up earlier it was about 10% now it is 20% so all these factors have basically resulted in our employee cost going a little higher. However, I must share that as our operations pan India get stabilized as our volumes from each of the plants go up. Over a period of time the rate of growth of employee cost will not be as it has been in the past.

Archit Ranka: So it will come down in the future?

Manish Dhariwal: As a percentage to sales it will come down, but in absolute terms, it will obviously go up.

Archit Ranka: So one final question sir, is regarding your revenue guidance which you have given like it's going to grow around 10-15% in the future, like around 12-15% and you're saying that the margins are going to remain stable so we can expect that the profit growth will be around 10-12%; 12-15%, same as the revenue growth in case the expenses remain the same, the margins remain same in future?

Manish Dhariwal: We have not given 10% or 15% guidance, what we have continuously maintained is that we grow at a rate higher than the industry and we are continuously demonstrated that and that is basically because of our continuous efforts in increasing our number of products that we are supplying, increasing the number of customers to whom we are supplying and increasing the base with the existing customers. So that trajectory is expected to continue. And once the size increases, then obviously the results of the `operating leverage and all these factors will contribute, so the profit typically grows at a rate higher than the top line growth.

Moderator: Thank you. Ladies and gentlemen, that was the last question, I now hand the conference over to the management for closing comments, over to you.

Abhishek Jain: Thank you Zaid and team of Concept for organizing this conference call. I would like to pay my sincere gratitude to all my analyst and investor friends who have taken time out of their busy schedule to listen to us today. Please feel free to contact Concept or us in case you have any further questions. Also, if you happen to be in the NCR region do give us an opportunity for you to show around our world-class operations. Thank you.

Moderator: Thank you very much sir. Thank you all for being part of the conference call. If you need any further information or clarification, please mail us at snighter@conceptir.com. Ladies and gentlemen this concludes your conference for today. Thank you for joining us and you may now disconnect your lines.

- **Ends** -

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