Talbros Automotive Components Limited
Q 2 FY 16 Earnings Conference Call
November 23, 2015

Moderator: Ladies and gentlemen good day and welcome to the Q2 FY16 Earnings Conference Call of Talbros Automotive Components Ltd. 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 should you need assistance during the conference call please signal an operator by pressing '*' then '0' near touchtone phone. I now have the conference over to Mr. Anuj Talwar, Executive Director. Thank you and over to you, sir.

Anuj Talwar: Thank you so much, good evening everyone a very warm welcome to our Q2 FY 16 earnings call. On the call today I'm joined by Mr Navin Juneja, our Director on the board of Talbros and Group – CFO, SGA our Investor Relations Advisory Company based on Mumbai. The result and the presentation are uploaded on the company website, I hope everyone has had a chance to look at it.

Let me give you a run-up on our performance till date, post which Mr. Juneja will take you through the financial performance of the company. We have completed half of the financial year 2015-16 on a subdued note, this subdued note predominantly has happened due to the decline in the sales in light commercial vehicles space and motorcycle area as well. Also we have had some weak global sentiments in Europe which has also impacted our sales for the half year. Although our core business, gaskets and forgings got hit by the various factors our joint ventures continue to perform as per our expectations and on path to value a credit to our consolidated business. We have been a leader in gaskets for five decades and now are well diversified player in the auto ancillary space. Our product segments include forgings, suspension systems, anti-vibration products and hoses we are present across all segments in the auto sector ranging from two wheeler, passenger cars, commercial vehicles and tractors & off-loaders. We also cater to OEMs segment in India and overseas, half the markets have exports OE business. Being present across all segments and across all platforms from two wheelers to trucks, we keep us very hedged against market cycles. FY 15 we had a healthy mix of 67% came from OEM business, 19% from export and the balance from the aftermarket.

Our business is broadly divided into a standalone gasket and forging business as I mentioned to you earlier and our three joint ventures were global auto comp leaders. A bit on gaskets being 100% asbestos free material company. We are now taking our gaskets business overseas we have already won some orders from Volvo for the US market, from a manufacturer in Turkey and a business from Ducati Motorcycles, Italy. We are also working closely with the new partners in America, Turkey, Iran, Mexico we are expected to get good orders going forward. Talbros is one of the few companies from India who participated in the Iran Trade Show and we have already secured some businesses from Iran as well. We were also in Las Vegas with US being the large market for our products and trying to tap new customers. Our vision in gasket business is to take the exports up from 13% currently to about 20% over the next three years.

We are also taking new initiatives to increase our reach in the aftermarket, we have just sanctioned a capacity enhancement in our Sitargunj unit which is catering only to the aftermarket and will become completely independent by Q3 of this year. The aftermarket supplies currently are about 11% of our half yearly sales. We continue to be a leader in the gasket segment with close to 38% market share in India and we also command about 90% market share in the two wheeler space in the domestic market. Our in-house tool design and manufacturing capability helps us to cater customer requirements from the early stage of engine development. Gasket as mentioned earlier contributes 73% of the entire revenue the company.

Another new segment is Heat Shields, heat shields line has been commissioned we hope this line is up and running by Q1 of next financial year and we are securing new orders, we have already received from Volvo in US and Mexico for Heat Shields and some also in the domestic market. It is another growth segment.

Forgings business contributes about 17% of our revenues and as a part of our export strategy we have a strong presence in the overseas market with 51% of our business coming from exports largely from Europe and in the agrarian off-loader space. We are currently looking at restructuring our forging business through strategic options to be able to generate new growth drivers and new business.

We have a 50:50 joint Venture with Magneti Mareli Chassis Systems with a scope to design and develop complete chassis for OEMs. We currently manufacture and sell control arms to the leading OEMs in the country. Today Maruti Suzuki sources 50% of the control arm requirement from us.

There is also a new project which you must have seen in the media recently it is called Bajaj RE 60 quadricycle. We are in chassis components we have very high revenue from this particular product, our aggregate revenue is about Rs. 7000 per quadricycle, in the front chassis and the side chassis. We have already received orders of about 4000 units for Turkish market. So this will be a big jump in our joint-venture.

Our latest joint-venture with Marugo Rubber, Japan caters to the OEMs for anti-vibration products such as strut mounts, suspension bushes, engine mounts and hoses. Our major customer of this is Maruti. One thing I would like to highlight is with Marugo Rubber and Magneti Mareli all the new vehicles that you're seeing in media these days like the S Cross, the Baleno, the new generation cars are all being supplied by these two joint ventures Magneti Mareli and Marugo Rubber. Our hose plant has commenced operations in October 2015 and we are currently running five orders for few key OEMs.

The second quarter continues to be challenging with weak demand from the LCVs and the two wheelers and also because of erratic order schedule from key OE customers which led to delay in supplies thereby affecting our aftermarket revenue. But the good positive sign is that we received new orders for Magneti Mareli and Talbros Marugo. As our new joint ventures who cater to passenger vehicle segment maintain their growth in the coming years, our position as a hedged player in auto components space will get stronger with better hedge to auto cycles. We continue to make progress in the global markets as well. Now I request Mr. Navin Juneja to update you on the operational and financial performance of the quarter. Navin over to you.

Navin Juneja: Thanks Anuj, good afternoon to everybody on the call. Let me first give you a brief about the auto sector performance in the Q2 of FY 16. The auto industry grew marginally in July to September quarter led by passenger vehicle sales. Passenger vehicle sales grew by 5% led by 7% growth in passenger cars, the commercial vehicle segment grew by 11% led by a strong growth of 38%in M&HCV which was negated by 4% decline in the LCV segment. A decline in motorcycle segment eroded the good performance from scooter segment. For the first half of the year the performance was in line with the quarter, passenger cars grew by 7%, commercial vehicle segment grew by 6% led by 23% growth in medium and heavy commercial vehicles but a weak 3% decline in light commercial vehicle segment. In two wheelers segment growth in scooter sales were set off by a decline in motorcycle sales.

Coming to our segmental performance. In the gasket division including Nippon Leakless Talbros, we saw an impact in production due to erratic order schedule from our key OE customers, a weak demand from LCV and the motorcycle segment which also affected our sales. We have completed our capacity enhancement activities in our Sitargunj plant, the plant will be now managed independently for aftermarket supplies from next month onwards. For the first half in gaskets our product mix changed more in favour of OEMs because of the strong growth in medium and heavy commercial vehicles. To maintain 100% single source supplier to Hero motorcycles and to avoid the competition we offered price reduction which was effective from last quarter of last financial year thereby affecting our profitability to some extent.

Forging division witnessed an impact of the slowdown in Europe and the weakening of the euro currency while prudent hedging measures helped us to cushion a part of the impact, we are in the trial stages with the customers in new geographical areas to diversify our geographical risk. A good order offtake is expected for the final quarter of this financial year in this business.

Coming to Magneti Mareli Talbros Chassis Systems Pvt. Ltd., the joint-venture as I have told you earlier is progressing well we have won new orders from Tata Motors for Control Arm Assembly.

Talbros Marugo Pvt. Ltd. this joint venture has also been performing very well. The joint ventures completed two full years of operation and has been delivering profit for the last three quarters in the anti-vibration products segment. This business is building a stronger order pipeline of new orders across all models of Maruti Suzuki India. The hose plant which we started, about nine months back has now started commercial production in October 2015 and we are in the advanced testing stages with our key customers.

Now coming to the financial performance of the company. In the quarter ended September 2015 we had a forex loss of Rs. 21 lacs against a gain of Rs. 40 lakhs last year same quarter, if we exclude the forex impact our sales was flat at Rs. 97.9 crores led by a slowdown which is primarily led by slowdown in two wheelers and CV segments. Our EBITDA was at Rs. 10.9 crores with a margin of 11.14% which has an impact of high OEM sales in the gasket division and the higher share of domestic sales in forging. Our PBT for the quarter was flat at Rs. 4.1 crores.

For the half-year ended September 2015: In the 1st quarter of FY15 we have received a dividend of Rs. 72 lakhs from our joint-venture partner Nippon Leakless, which got delayed in the current year and is expected to be received in the coming quarters of course more or less confirmed now. For the half year we also had a forex loss of Rs 35 lakhs against a gain of Rs 60 lakhs in the half year of the last financial year. If we exclude the impact of dividends and forex our sales grew by 2% to Rs.194.5 crores, our EBITDA was marginally lower at Rs. 21.2 crores with margin of 10.9% which is due to lower absorption of fixed overheads including all fixed assets. PBT was lower at Rs. 7.6 crores with a minor growth of 2% which was primarily because of lower depreciation charges. We had already refinanced a portion of our loans and renegotiated interest rate to the bankers this will help us in savings towards the financial expenses in the coming quarters. I think this is all from my side.

Anuj Talwar: Thank you Navin, we will continue the rest of the year with focus on gaining new businesses in our joint ventures, export markets and increasing our share in the aftermarket as well. Despite market challenges we maintain the momentum in getting new orders and increasing our market presence. As volumes picks up in the coming quarters led by the continued pickup in the commercial vehicle sales I am pretty sure that our gasket business will do better as it is heavily dependent on the commercial vehicle segment. We also expect a recovery in the two wheeler sales as well as you all must have read in the media that Indian auto comp industry grew by 22% in the month of October which is a good sign around the diwali time. With that I would like to thank you all for joining the call and we hope that we are able now to answer questions.

Moderator: Thank you very much. We will now begin the Q&A session. We have a question from the line of Mahesh Bhendre from Way2ealth Securities. Please go ahead.

Mahesh Bhendre: Given the slightly weak performance in this quarter what kind of business outlook we see for the rest of the year and FY 17?

Navin Juneja: First of all performance was flat, not weak what I want to say of course the segments which we are leaders first is two wheelers it has suffered a bit and of course my aftermarket has come down because of the erratic OE orders, OE is literally has given us very erratic orders. Sometimes in the first week they say they require X numbers, second week they say they require X minus 25% with the result I was not able to decide an order schedule because I'm a single source to them so it has affected my performance as a segment. If I had got the normal schedule my sales would have been better by two crores minimum. As regards third quarter and fourth-quarter we are quite hopeful. In the auto industry first two quarters are always slow as compared to the last two quarters. In our business we delegate 45:55 if it is 45% so next half should be 12% growth minimum that is my outlook. If you see number wise in the gasket I am looking at a turnover of minimum of Rs. 255 crores on an annualized basis and forging it should be Rs. 70 crores.

Moderator: Thank you. The next question is from the line of Punit Gulati from HSBC. Please go ahead.

Punit Gulati: Can you give us more color on your comment that the orders from OE is erratic and if you suspect this could continue in the next couple of quarters as well?

Navin Juneja: Future I cannot comment on, because as always where we are a single source like Volvo, Cummins, Honda. We receive three months projections in advance, on that basis my major raw material for these customers will be imported, all the orders for raw materials receive in advance as a result there is a lead type of two months because it is coming from US by shipment, ordering time you can take three months, approximately for 2 1/2 to 3 months of materials are ordered. Before the load starts the schedule suppose they have given is of for example of 10,000 pieces, then they say they require not more than 6000. Our money gets locked in the material, after we raise a supply n the middle of the month they might also change to 12,000 pieces, Sometimes they order models not planned earlier. We immediately freight the need raw material for them because we are single source adding to costs. The result might impact the production planned for other segments like export and aftermarket suffer.

Punit Gulati: Is it normal course of business for these particular customers or what is driving for them?

Navin Juneja: Of course we can understand 5 to 10% but nobody can evaluate future accurately.

Punit Gulati: But what I'm trying to understand if you have some colour on why these customers are behaving this way or is it just a normal way of how they do the business?

Navin Juneja: Normal way would be 5 to 10%.

Punit Gulati: So any particular reason that these have communicated to you why there was such erratic orders.

Navin Juneja: Our market also has not been consistent in behavior,. If you see for the first half this financial year the growth has been erratic in all most all vehicle manufacturing industry.

Anuj Talwar: Also I would like to add, we also represent Talbros on ACMA, this erratic behavior of heavy commercial vehicles is due to a very high schedule earlier and now you have broken the schedule that is more stable. And we see that Q3 and Q4 onwards there will be a good positive growth in the auto comp industry.

Navin Juneja: 9 – 10 % variation is normal I can say.

Punit Gulati: These customers are US based or the Indians when you say Volvo, Cummins you are exporting?

Navin Juneja: We are exporting and Cummins, Jaundier and Volvo they're also exporting and we supply to them, but you not know how much they export.

Punit Gulati: Because their order intake will depend on the demand that they see from their customers so I want to understand whether this demand was affected by the Indian customers or was it the global customers.

Anuj Talwar: Majorly Indian customers. From gasket business Indian customers and from our forging business it is export customers because in the forging business 50% is exports. Europe has a tremendous slowdown right now, Italy that has affected our forging business and in other domestic space our gasket business. That is why we are putting more and more impetus in gaskets towards the aftermarket. So that to make the plant independent we are investing in Sitargunj plant I think it must be over by this month-end or early next month so that my dependence on this plant is low.

Punit Gulati: These customers are again for the Indian market for gasket business.

Anuj Talwar: Indian customers basically.

Punit Gulati: Secondly you also mentioned in your presentation that Nippon Leakless you have been forced to give price reduction, what is stay really and why has the competition sharpened a bit now?

Navin Juneja: As you are aware Hero was representing a Honda company, so my NLK was that referred source in Honda, now hero has become an Indian company no more a Honda company. They have appointed Deloitte to look at their cost, to reduce the cost so that they can face the competition and more efficiently. Because for them NLK is one of the supplier, is not the preferred supplier.

Punit Gulati: So who are the other players who are competing in this space right now?

Navin Juneja: Other players are Looking for entry and they offered some price to make entry.

Punit Gulati: So who are these customers?

Navin Juneja: I do not want to name them. Everyone wants to make an entry in Honda. It is the largest motorcycle scooter manufacturer in India so to block the entry we are forced to offer price reduction.

Punit Gulati: Has strategy been successful?

Navin Juneja: We will remain a single source. This is being offered last quarter last year when you compare next quarter with last year after two quarters all numbers will be in line.

Punit Gulati: Also if you can give breakup between various businesses like the way you shared last time EBITDA margin for gasket, for forging and how they've changed on a QOQ basis?

Navin Juneja: Standalone EBITDA margin for FY 16 half year it is 10.7%, gasket approximately 13.5%, forging is 0.5% for the six months it has the dual effect of foreign currency loss and loss of business.

Punit Gulati: It is positive because Q1 it was -1%, so it has improved 2.5%.

Navin Juneja: Half-year it is 0.5%. My Nippon Leakless half-year is approximately 18%. MMT is -1%, Margo is 11%.

Moderator: Thank you. Our next question is from the line of Aditya Sundaram from Edelweiss. Please go ahead.

Aditya Sundaram: I missed your initial remarks, if you could basically elaborate a little more on the orders that we have won in this quarter especially on the domestic side for the quadricycle and some export orders apologies again if you have to repeat but if you could just elaborate on that a little more?

Anuj Talwar: One is the usual growth that is happening in automotive industry, I did mention that my joint ventures, if you see on media these days advertising new cars like Baleno and S Cross my joint ventures with Magneti Marelli I have secured 50% of Maruti's car production on a particular product called Control Arm Assembly all the future cars coming up even their small mini SUV have got the orders for that. So for anti-vibration and hose plant which is Talbros Marugo has got all the orders of the future cars.

Aditya Sundaram: Are we present on S Cross and the Baleno?

Anuj Talwar: Yes

Aditya Sundaram: And Magneti Mareli.

Anuj Talwar: And with Marugo Rubber. Basically it is Maruti Suzuki for both the joint ventures makes it about almost 80-85% of the customers for two JVs. Quadricycle I mentioned that there is a very big opportunity from Magneti Marelli again because per part the revenue has got Rs. 7000 and right now I'm not budgeting for the next year I do not know whether to budget 8000 cars, 10,000 cars, 40,000 cars , but I'm ready with the capacity in Faridabad I can supply of almost about 25,000 cars from the current capacity, they're applied for the government to give clearance to Mr. Rajeev Bajaj touchwood the company will take off.

Navin Juneja: As you know we have been placed already with that vehicle, already we have received orders for 4000 pieces we are in the process of supplying to them, exporting to Europe in countries as you have seen the paper that Turkey the first car has been registered.

Anuj Talwar: Also in gasket I would like to mention to you is that we won an order we have focus on exports we won orders from Ducati Motorcycles, Volvo Mexico for Heat Shield a very big tractor manufacturer in Turkey, OEM in Iran our focus is very strong on exports, because he personally feel that we cannot be always depending in the Indian auto industry because it is very cyclical in nature.

Aditya Sundaram: Only the Volvo order from here is Heat Shield?

Anuj Talwar: It is correct.

Aditya Sundaram: You said 80-85% of your revenue from Magneti Mareli and Marugo comes from Maruti, now Maruti has been a standout in terms of growth in this quarter what has been the growth of the Mageti Marelli and the Marugo Rubber side?

Navin Juneja: The business has just started over six months, Magneti Marelli last year it was Rs. 32 crores this year Rs. 14 crores my share in the 1st half. The growth of 15% is there. Marugo this year Rs. 5.2 crores approximately last year it was Rs. 6.5 crores our share.

Aditya Sundaram: The basic reason in the lower EBITDA margin Magneti is because of the delayed ramp up, is that the overheads are hitting the numbers?

Navin Juneja: Because of high depreciation and final cost. Everything is in place all the materials everything is in place we are waiting for the cars.

Aditya Sundaram: Why I'm asking because in the previous quarter you mentioned -1% EBITDA margin for H1 for Magneti Marelli I was just wondering you have done about as per the number you gave me 17% YOY growth.

Navin Juneja: I think breakeven level achieved by the end of the next financial year 16-17.

Anuj Talwar: Magneti Marelli is a highly capital intensive business and raw material percentage is very high out there it is about 73-75% unlike our gasket business which is much lower, so that breakeven takes about Rs. 80-85 crores, the mini Bajaj cars quadricycle will be in the profit. We have put a lot of investment for Bajaj. Almost 25% of our factory is Bajaj but nothing happening over there.

Navin Juneja: I think we are hopeful that we'll get the Indian approval very soon and everything will fall in line.

Anuj Talwar: At least we should make cash money next year,.

Aditya Sundaram: I wanted to know Magnet Marelli side the raw material that we have the decline in prices is currently occurring is it an immediate pass on the full effect?

Navin Juneja: Because it is basically an OE based company. They did not purchase, we can get a benefit of one month.

Aditya Sundaram: If you could give me the CAPEX number for the year that we're planning and maybe for the next year for FY17 also?

Navin Juneja: This year I think all CAPEX are over, in this year I did a CAPEX of Rs. 9 crores in gasket business. Forging approximately Rs. 1 crore, in Magneti Marelli less than Rs. 1 crore, in TMR for hoses approximately Rs. 9.5 crores and Nippon Leakless hardly Rs. 1 crore. Next year my plan is gasket Rs. 9 crores, forging Rs. 3 crores, Nippon Leakless of Rs. 4 crores and Magenti Marelli of approximately Rs. 2-3 crores and Marugo approximately Rs. 2 crores.

Moderator: Thank you. Our next question is from the line of Vikas Rajpal from East India Securities. Please go ahead.

Vikas Rajpal: You have secured orders for Heat Shield from Ducati and some other company but in the last call

Navin Juneja: Ducati is gasket.

Vikas Rajpal: Sorry, but you got orders from the Heat Shield division?

Navin Juneja: From Volvo.

Vikas Rajpal: But in the last call you had mentioned that the Heat Shield machinery will be installed by January 2016 but this time you have mentioned that in the first quarter of next year it will be installed so what is the reason for the delay?

Navin Juneja: Most probably we will inaugurate the machine in the month of February with auto mechanized, auto Expo is there in the first week of February and we are expecting our JV partner to open this facility and will show case the facility to the OE customers in February.

Vikas Rajpal: The main supply will start from the first quarter.

Navin Juneja: The existing orders only whatever we have got Rs. 4-5 crores we will start doing there but next bulk order will take 9 to 12 months because the showcase facility orders start coming it will take some time for that.

Moderator: Thank you. Our next question is from the line of Hitesh Shah. Please go ahead.

Hitesh Shah: My question is on the export side are we getting into the newer geographies, last time we entered into Turkey so any new geographies addition that we have done in this quarter?

Anuj Talwar: Mexico is a new customer, Turkey is a new customer, we are also looking at Iran, Italy also is a new segment. Setting our ties in America with our gasket division.

Hitesh Shah: The other one was on the margin side so would you like to share outlook for the rest of the year or for next couple of years?

Anuj Talwar: It may be 0.5 - 0.75% more because of one year softening of metal pricing number one, number two increase in the heavy commercial vehicle demand also the positiveness shown by the auto industry in the month of November, cost reduction measures taken by us and few new products coming especially in the joint ventures from Q4 onwards, so yes 0.5 to 0.75% is the improvement in margins.

Moderator: Thank you. Our next question is from the line of Aditya Sundaram from Edelweiss. Please go ahead.

Aditya Sundaram: I wanted to ask you these orders that we have won could you basically quantify the size in terms of value as an overall opportunity for us?

Navin Juneja: These are the first orders of four crores of the core value, once we supply they will see our supplied quality among other things and then the bulk order will start.

Aditya Sundaram: Approximately in what ballpark should these could be?

Anuj Talwar: About Rs. 15 crores in the next 2 to 3 years but having said that we are still working on one or two more prestigious orders as well. Forging business is the main large orders.

Aditya Sundaram: Wanted to find out not just for 2016 basically because the industry is slowing down significantly on the domestic side, how do you see your margins in terms of going forward at FY 17 EBITDA margins, would you be able to maintain 12%?

Anuj Talwar: We are targeting to maintain at 12-14% it is not higher.

Aditya Sundaram: How do you see that in terms of industry?

Navin Juneja: Order book.

Aditya Sundaram: All orders coming at higher margins or they are at steady state margins?

Navin Juneja: Same margins are not being affected.

Aditya Sundaram: So we are seeing the basic growth is going to come in for operating leverage that is why we see that is happening?

Navin Juneja: Operating level because I have the capacity, I have everything more or less in place my fixed cost is already there, I had to grow because my basic major cost which I think everyone incurs is my manpower cost goes up by 8-10% every year I had to increase my sales too, first of all if my cost is there I have to increase my sales to 10 to 12% to take care of that.

Aditya Sundaram: What utilization are we currently operating at?

Navin Juneja: In gasket I have the capacity to produce up to Rs 23 to 24 crores per month and I am producing on an average Rs 20 crores for the last 10 months, Nippon Leakless is approximately 8%, Magneti Marelli I can produce up to Rs. 80 crores I am producing at Rs. 57-58 crores, Marugo plant is new, my anti-vibration can produce up to Rs. 2 crores per month I am producing Rs 1.4 to 1.5 crores per month, hose is negligible I can produce up to Rs. 10 crores. Hose plant I am just doing trial run I can produce up to Rs. 10 crores per annum from there.

Aditya Sundaram: The overall capacity was how much for the hoses?

Navin Juneja: Approximately Rs.10 crores.

Aditya Sundaram: How much is the capacity capable of producing Rs. 10 crore sales is what you're saying?

Navin Juneja: No I have just started to production and just doing that.

Moderator: Thank you. Our next question is from the line of Arun Malhotra from **Sentlum Capital.** Please go ahead.

Arun Malhotra: Just wanted to understand the impact of refinancing, what would be our new effective interest rate and how much it would add to the P&L?

Navin Juneja: We changed our term loan unsecured loan and the effect is 1% per annum. The loan amount was approximately Rs. 18 crores.

Arun Malhotra: On the forging business you have eroded that business in the past that you would probably looking at scaling up that business any plans of what about your thoughts on the business?

Navin Juneja: We are already working on that I cannot disclose the plan. We will come back to you by next to 3 months.

Moderator: Thank you. Our next question is from the line of Hitesh Shah. Please go ahead.

Hitesh Shah: My question was answered thank you.

Moderator: Thank you. Sir there are no further questions would you like to add any closing comments Mr. Anuj Talwar.

Anuj Talwar: As I mentioned to you earlier that we are looking at better demand in the auto industry, there was a nice demand came in the month of October-November there was Diwali. I personally feel that it has been utmost that the good times are here and finally the auto industry the interest rates are coming down for example the buying is again happening we are focusing on other markets, after markets and exports a decent growth percentage over last year we have not been exponential growth percentage but I'm pretty hopeful that things will really turnaround from Q3, Q4 onwards and I would see a very good financial year next year as well. So we have got a very clear and segment wise approach happening in various segments such as OEM, after markets, and exports.

Moderator: Thank you very much members of the management. On behalf of Talbros Automotive Components Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.