SMRPBV - Quarter Ending 30th June 2015 Friday, 07 August 2015

Vaaman Sehgal: Ladies and gentlemen, welcome to the conference call. I am joined by Mr G N Gauba, Mr Kunal Malani and Mr Vipin Jain, who will assist me in answering the questions for you today. Just to take you through the highlights, I think we had a very strong quarter. The revenues were up 20%, the EBITDA margins were up 15% and both the units have shown impressive growth in both the top line and the bottom line. Without much further ado I'll request Vipin to take you through a bit more in detail of the quarter performance and then open it up for your questions. Vipin, on to you, please.

Vipin Jain: Thank you, Vaaman. Good morning, good afternoon, ladies and gentlemen. My name is Vipin Jain and I am the CFO of the company and I will be presenting you the unaudited interim consolidated financial statement of the company for the quarter ended 30th June 2015. During the call I will be referring to the presentation which we have uploaded onto the company website a couple of hours back and I hope that most of the participants will be having the copy of the presentation.

I am now referring to slide number two, which is the slide on the group structure and if you look at the group structure there is no change with respect to the last quarter call which we did and group structure is the same as we discussed the last time.

In terms of the global presence, which is in slide number three, again there is no change in the global presence. We continue to operate from 45 manufacturing plants, 20 for SMR business, 23 for SMP and two for SMIA business, having presence in 16 countries and more than 21,000 motivated workforce.

One point which I wanted to highlight on this particular slide is that we are also working on two Greenfield plants and this is for the SMP business, One is in USA in a place called Tuscaloosa and one new plant is coming up in Kecskemet in Hungary and these are basically to cater to the new orders of the customer.

I move to slide number four, which represents the revenue and EBITDA of the group and from this quarter onwards you will see that we will be presenting the corresponding previous quarter of the previous year to facilitate comparison. Last year we were not having a similar comparison but now we have moved to the second year of IFRS consolidated financial statement, we have comparative quarter information.

This information is further divided into SMR and SMP businesses and as Mr Vaaman Sehgal highlighted, the business has seen impressive growth in terms of the top line; revenues were higher by 20% and this growth was coming both from SMP and SMR businesses and if you look at EBITDA, EBITDA is also higher by 15% and again there is a consistent improvement coming from SMR and SMP business.

The revenue growth is largely driven by the strong demand in the American market. We also started commercial production from a Greenfield plant at Schierling in Germany. This is for SMP business and SMIA, which was not there in quarter one of the previous year, had turnover for the full quarter in the current year. This growth was partly, I would say, off-setted by a slowdown in China market and the Brazilian market where the sales were a little low, as per our expectation.

We move to the next slide which is on the trade working capital and if we see from the current slide, there has been a consistent improvement in the working capital of the company, reducing from 20 days which was in June 14 to 14 days which was in June 15. March was lower at 8 days and for the participant who attended the last call, we mentioned that March was a little bit lower because of the higher creditors which was on account of the new plant capitalisation which was pending engineering approval.

Inventories have been by and large consistent at around 16 days and the receivable has improved to 43 days. We move to the next slide which is on the capital expenditure which is slide number six. Slide number six represents the capital expenditure for the quarter ended June, which is €60.6 million and this is divided into SMP €37 million and SMR €23.6 million.

A point again to note on this slide is that €42.4 million expenditure was on the new plant which accounted for approximately 70% of the total capital expenditure of the group.

Slide number seven, which is our next slide, gives the detail on the cash flow and if we look at the cash flow for the quarter, operating profitability continues to be strong, generating the cash flow of close to €57 million but again, as I explained on the previous slide, there was a decrease in the trade creditor which consumed 50 million in terms of the working capital and we also have a tax outflow of 7.7 million.

Cash outflow on account of capital expenditure was €74 million, which was higher than the total capital expenditure as per the previous slide on the capex and this was again because of the payment of the capital creditor, which were outstanding as of March 15.

Cash flow from financing activity reflects bond proceeds, which was partly used for repayment of certain revolving credit facilities and the closing cash balance was at €169 million and this is expected to be used towards the payment of capital expenditure in the coming quarters.

I move to the next slide, which is on the cash and debt status of the company as at 30th June 2015 and if you look at this slide, due to the issue of bond in the current quarter there has been an increase in gross debt of the company and gross debt is at 646 million against a gross debt of 585 as on March. Also the increase in net debt has been explained in the previous slide on the cash flow and this is largely coming from the capital expenditure which we have incurred in the previous quarter.

A few other points to mention on this slide is a new bond which we did in the current quarter. This is for the amount of €100 million and this is for a period of ten year. We also refinanced couple of revolving credit facility and we have some more details on the next slide so we can move to the next slide, which is slide number nine.

So if you look at slide number nine, we had a new bond issuance which was done at a coupon of 3.7%, which is a better coupon rate than the previous bond and this bond is also rated by Standard & Poor at BB+ with a stable outlook. We also expanded our RCF facilities from €125 million to €350 million at better terms in terms of the pricing and there was no change in the RCF2 for €50 million. By doing this financing arrangement we tried to achieve a robust capital structure with a better coupon rate and we also extended the banking relationship because in the old RCF we had 6 banks but in the new RCF we have 14 banks and these banks are coming from all the regions, from the American banks, European banks in addition to the Asian banks.

We move to the next slide and the next slide gives us the status on the liquidity as at 30th June and if you look at this slide, the company had access to the liquidity of €550 million approximately, which is represented by the unutilised portion of the committed revolver credit facilities, plus the cash and cash equivalent of €169 million. The leverage ratios were also much better in terms of the threshold; the gross leverage ratio was 2.69 against a threshold of 3.5 and the net leverage ratio is under 2 against a threshold of 3.25.

Next couple of slides from slide number 11 to slide number 15 give the detail on the new expansion of the plants which we are doing currently. So maybe we can just glance through those slides. Slide number 11 gives the detail of the upcoming facilities in Americas, slide number 12 gives the details on the European region and slide 13 as well. Slide number 14 gives the detail in terms of the China expansion and slide 15 on the other Asia Pacific region.

The last slide, which is slide number 16, talks about the customer recognition. In the last conference call, we shared with all the participants that we got award from Daimler, which was in the category of “Partnership” and recently we have got award from Volkswagen group and this is also a global supplier award and this is awarded in the category of “Global champion”.

This was a brief presentation which I wanted to share with all the participants on the call and with this I conclude my presentation and I hand over back to Mr Vaaman Sehgal.

Vaaman Sehgal: Thank you so much, Vipin. Now we would like to open up the question and answer session.

Operator: Ladies and gentlemen, please press * 1 to ask a question or if you change your mind and wish to withdraw your question then press * 2 and please ensure that your phones are unmuted locally. Once again, that’s * 1 to ask a question.

If there are any questions please press * 1 now.

We have one question from Andre Fouterat from Allianz. Please go ahead.

Andre Fouterat: Yes, what explain the double-digit growth that you experience this quarter? Was it just new contracts or are you taking some market share? And add on to this; some people are getting worried about the current situation in China. What's your view there, do you see any big decrease in sales – sorry, you see big slowdown of sales?

Vaaman Sehgal: Thank you so much for your question. So for the first part, we really don't analyse that much in detail whether it is new business or market share. Definitely we are growing with the customers. There are new platforms being awarded to us. There are also new businesses that we are getting. We talked about the new plants that have started up and are now taking the new programmes up so all of that is combining to the increase in sales. It's very healthy, it shows the customers' confidence in us and our ability to continually win new programs.

Secondly, China definitely, while we're watching it closely, we don't think it's the cause of a panic or anything like that. We think, you know, every country at some point goes through an up and down and our policy of having 3CX15, you know, trying to get no customer, no component or no country to a huge part of our sales categories, as below 15% as possible is a continuous effort on our side to mitigate those risks and we continually do that.

So with our geographical spread we're able to move resources from one place to the other when we see some softening but definitely we're keeping the environment in check in China and in Brazil since we're seeing some softening over there but it's all part of the normal business as we see and we don't see any knee-jerk reaction to what's happening there. The fundamentals are strong.

Andre Fouterat: Okay, thank you.

Operator: The next question is from Nitij Mongal from CLSA. Please go ahead.

Nitij Mongal: Hi, thanks for the opportunity. What I want to understand is for SMP-like business, for, you know, once you set up a plant and that reaches full capacity, what kind of asset turns can that plant generate?

Vaaman Sehgal: Look, there are different parts to that. It depends on what product that plant is manufacturing, exteriors, interiors, painted parts so it depends on the programmes, it depends on a lot of those things so we don't really calculate the asset turns. As you know, we focus on return on capital employed and we try to get as close to 40% if not exceed it and that's our primary target.

Nitij Mongal: Basically what I wanted to understand is some relationship between what kind of capex is required to generate what kind of top line because, I mean, the historical balance sheets of SMR and SMP are, you know, obviously different because these were assets acquired from the administrator but for a new plant is there any relationship, you know, or any thumb rule for the industry that, you know, you need to spend so much capex in this kind of business for, you know, some kind of top line?

Vaaman Sehgal: No. In fact it's not easy to generalise in our business because we're not making standardised products. Each programme, each customer has different requirements, different value of product that are going in there so again, you know, we focus on the metrics of return on capital employed and when, you know, some things don't make sense to set up our own plant we have buy-outs and we do make-buy analysis and put that up.

So you need to appreciate that our products are supplied just in sequence, just in time, just in line to car marker so we obviously make sure that we only build the plant once we have sufficient orders in hand that will make sure that we're able to get our, ROCE targets and our internal targets and only then do we consider making those investments. Again, we have wide range of customers, wide range of models that we cater to so there is no real thumb rule or one rule that can be generalised to the plants.

Nitij Mongal: Okay

Kunal Malani: Look, very simply put if you're making a Daimler mirror or making a PSA mirror, the capacity utilisation, the capex that is going behind it is pretty much the same, but there's a fair amount of embedment that happens in the Diamler mirror which is SMP portion of it.

The ultimate costs of it are obviously very, very different. Now, from a capex perspective pretty much the same level of capex is getting done and hence depending upon the product which the asset ratio generates, right.

Now, what is important, you know, for you to understand is ultimately from our perspective the asset turnover is only one part of ROCE. ROCE at the end of the day is assets turnover plus margins. Now, for us there could be a situation where the asset turnover could be low but the margins could be very high and accordingly we could still achieve the 40% ROCE.

In another situation the asset turnover could be very high but margins could be low, right, so that is why we follow and look at ROCE rather than looking at asset turnover.

Nitij Mongal: Okay, understood. Secondly, Brazil would be what, I mean, what part of your overall console revenues for SMRPBV

Vaaman Sehgal: Vipin, can you give that figure?

Vipin Jain: Yes, Vaaman. So Brazil would be a very small number and Brazil would be something like 2.5% to be very precise but it's a very small number between 2% to 3% of the total revenue.

Vaaman Sehgal: Thanks, Vipin.

Nitij Mongal: Okay, thank you.

Operator: If there are any further questions please press * 1 now. We do have a question from Chirag Shah from Edelweiss. Please go ahead.

Chirag Shah: Yes, thanks for the opportunity. Just wanted to understand on a longer-term basis, if I look at one of your older presentation of June 2, there you highlighted how you are looking to drive your margins and improve your competitive positioning and the vertical integration and the operational improvement and cost improvement; there are three or four heads you have mentioned broadly.

So given the fact that you are in a growth phase and every year some plants will be coming up on commercial production ramp up stage, how should one look at your margins improvement strategy, is it more driven by new business wins, as and where the share goes up you will see margins, or is it that when the balance between the number of plant under various start-up phase goes down it will have a big delta effect on your profitability?

Vaaman Sehgal: Thanks for that.

Chirag Shah: That's one part. Yes, that's one part and on the vertical integration side, if you can help us understand because you have been highlighting earlier in terms of raw material integration, in terms of supply security and the competitive advantage development on real development time reductions and so forth.

Vaaman Sehgal: Okay, Chirag, for the first part of your question, look, there's a whole combination of things that happens. If you look at it, I mean, a lot of the companies that we took over – SMP, SMR – they were running businesses so a lot of the programmes were actually old in the pipeline that we had to wait for them to completely finish for the new programmes to come in. Definitely the new programmes that are coming in are definitely at way better margins than those existing ones because of course then the company will be in a situation where we have to go and take it over.

So we put a lot of focus on new programmes, we put a lot of focus also on the existing programmes but sometimes we have to make that decision on, you know, if the programme is ending fairly soon; to make a lot of changes will actually involve a lot of cost because you have to go, revalidate with the customer, bring in different sourcings. That has to be again revalidated and a lot of those things, PPAP and things like that need to happen.

So we focus majority on the new programmes as well since we have a lot more control from design to final delivery of that programme and are able to try to get as big margins as we can on that programme. Again the focus is more on the return on capital employed rather than margins so I really can't guide you on that but our efforts are always there to improve the margins in each function of making that part and supplying to the car makers since of course that also add to getting as close to a ROCE figure as possible.

Secondly, the integration's, definitely it is happening. On the wiring harness side, SMR is fairly integrated and we are continuing to fill up all the remaining small voids that are over there. With SMP also we're looking at our own subsidiary companies, supplying those parts to SMP but again that's mostly coming in for the new programme so it takes time to scale and things like that.

When we took over these companies a lot of the focus was on improving the margins immediately so a lot of these things take time, they're happening and definitely in the coming quarters we should see that coming up a bit more and it's always a make or buy decision. Sometimes it makes sense to continue your sourcing from outside rather than bringing it in-house for some reason so we continue with that.

So these are decisions that our operating teams are taking, we give them full freedom to do that and of course, quarter on quarter as you are going you will see continual improvement. Now, if you're looking at it just from one quarter sequentially, we're not a sequential quarter company, a lot of things change, product mix changes, the new programmes that are coming in, start-up costs; all those things come into play.

So definitely we're in a phase of growth mode, we've stabilised the business completely and we are growing and new investments are being made for new plants, we are telling you all about the new plants, adding geographical locations and everything towards that.

So set-up cost is a part of that. We don't segregate those costs out because it takes the focus away since new plants and new programmes are a part of our normal business so we like to include it to show and keep the focus on that and not, you know, take that cost separately and kind of relax because, you know, that doesn't come out as extraordinary cost or something like that.

Chirag Shah: Fair point, I hope you're right. Yes, that's really helpful and if I have to understand on this new programmes, so since, for example, SMR which is a fairly stabilised business now, since the time you'd acquired and the business that you've announced, if I have to assume those are new orders, how much of the revenue currently in SMR would be from new businesses or the orders that would announce post acquisition of SMR that would be part of your P&L? It would be around 50, 70% of your revenues in the sense it would be because it's quite an old entity now for us.

Vaaman Sehgal: You're right in some sense because five~six years is the average life of a contract but there are still some programmes which we, when we acquired the companies, that have been won one or two years beforehand which started only after so those programmes are also in the pipeline. So I think the true reflection would only come maybe another two, three years down the line when it'll be 100% our own but even then we will be supplying spares and stuff for the earlier programmes.

So we're giving you a very back-of-the-envelope kind of a number but definitely as each year goes by that number is increasing.

Chirag Shah: And would it be a right statement to make that you have won a programme, say, in 2011 and when you win a new programme today, does the profitability matrix changes for you or what are the drivers for the profitability matrix or return matrix? Because it's now new business altogether so beyond a point the matrix shouldn't change significantly. The efficiency gains that come in and you would be able to drive your growth.

Vaaman Sehgal: Not necessarily, Chirag, because these are new programmes and in the middle of the programme there are, you know, refreshes and things like that that come in. Definitely our targets are fairly high but you have to understand that these programmes are won competitively so the market price determines that and we have to take a call whether we're able to see that we can improve those margins and the two years the time that they've won the programmes is the time that we start to do it and then we take a strategic call that, yes, maybe we've not warranted the margins that we expect.

But in the two years of the focus of the team in the production methods, the sourcing, the efficiencies and all those things combined, using of technology, we're able to bring it to the standard where we want it to be.

Chirag Shah: Fair point. This was really, really helpful. Thank you very much and all the best.

Vaaman Sehgal: Thanks, Chirag.

Operator: The next question comes from Hitesh Goel from Kotek Securities. Please go ahead.

Hitesh Goel: Yes, thanks for taking my question. My question is on China. What percent of the revenues would China form for SMRP BV? Second question would be in next five years what do you think China could be as part of the total sales? And finally, you know, if we look at last, from FY 14 to FY 15, SMR has been growing at a decent rate but also margins are stuck between this nine to 10% range and we're not seeing much plant additions in SMRs, only in the last quarters there are two mini plants which came in, I think, in SMR. So can you just tell us what is happening in SMR in that sense and what margin profile could be going forward?

Vaaman Sehgal: Okay, wow, a lot of questions there. Vipin, can you tell China percentage?

Vipin Jain: The China percentage, Vaaman, would be in the range of 7% to 7.5% of the total business.

Vaaman Sehgal: Okay. Unfortunately I can't disclose you the forward-going because those programmes are protected by the customer, I'm not allowed to give you the forward projections of what that business would be but I can tell you with confidence that we are building new plants over there based on booked orders so definitely that business is growing at a very robust pace.

Now and then you always have a quarter where, you know, sales have kind of come down for many reasons, macroeconomic reasons, not specifically to the car industry but definitely we do have what we call breathing with the market and we make sure that even at those times we have opportunity to cut any fat that we have in the business and make sure that, you know, we're constantly looking for opportunities to expand our business in the region.

When you talk about SMR, you know, if you look at year on year there's a constant increase every single year and a very drastic jump is not something that you should expect because we're a very stable and growing company and we're continually focused on showing you steady returns, growing every year on year as we move forward.

So I don't think that they will stagnating. I think they will increasing every single year. In fact we had, you know, 15 quarters or something like that where we had continuous expansions in top line and bottom line so I'm sorry, I'd have to disagree with you on that but definitely we're looking to, looking for ways and means how to constantly improve our ROCE and that entails a part of the margin expansion.

And as new products, new things are coming in there'll also be announcements of, you know, augmenting further capacities and expansions in plants. You know, the US is expanding quite significantly. We're also considering upgradation of some of the facilities that we have in the West but that will be disclosed to you in time when, as that decision has been made.

Hitesh Goel: Okay, and my follow up on that is you should see some operating-levels benefits. Right? I understand there's start-up cost because the new plants coming in so entire cost to sales don't come down dramatically. So when do you think these benefits will start coming in in SMRPBV, when the operating leverage benefits will start showing? Because your top line is still growing at 20% so I believe your operating level is pretty high. I just want to understand that.

G. N. Gauba: Hitesh, Gauba this side Definitely if we look at return on capital employed we are improving a lot at SMR and it is not fair to just see us on EBITDA percentage and we are one people who do not believe on that because there is a huge amount of value proposition that gets added and many times these may be, you may be more integrator. So we would encourage you to view the total performance rather than just remaining limited to EBITDA percentage or a margin.

Hitesh Goel: Okay, fine. Then finally, do you see your 40% ROCE on profit calculated on pre-tax including working capitals, is that right?

G.N. Gauba: We give the comparison of actual also. I mean, it is pre-tax and for the capital employed, whether it is for fixed assets or whether it is for working capital

Hitesh Goel: Working capital. Okay, thank you very much.

G.N. Gauba: And that's on consolidated financials so don't confuse that with this or something.

Hitesh Goel: No, I know, I'm just trying to clarify the guidance there.

G.N. Gauba: Let's not confuse the people on the call.

Hitesh Goel: Okay, no, sir. Okay, sir, thank you.

G.N. Gauba: Thank you.

Operator: As a final reminder, please press * 1 to ask a question.

We have a follow-up question from Nitij Mongal from CLSA. Please go ahead.

Nitij Mongal: Hi, thanks again. Just want to understand on SMP or since you are now, you know, it includes business of SMIA for last two quarters, would SMIA be a bit of a drag on margins for SMP given that it's a business recently acquired and maybe there is a bigger scope of improvement there or would that not be the case?

G.N. Gauba: I think SMP is being reported consolidated of SMIA and there is nothing called a drag on the business. Of course there will always be scope to improve it further but we can assure you it's not a drag on the business.

Nitij Mongal: No, basically what I just want to understand was because it's a recently-acquired business and, I mean, in the past you, you know, obviously improved the profitability of the businesses over time so is it that there's a bigger scope of improvement for margins in the SMIA part of SMP?

Vaaman Sehgal: Listen, it's going as per our plan. We are quite pleased with how the results are coming from that but it would not be fair to give it individually as it's a part of SMP. I can firmly tell you that it is not any sort of a drag on the business and it's performing as per our expectations so it's very much in line.

Nitij Mongal: Okay, thank you, and just what are your capex plans at SMRP over the next two or three years?

Vaaman Sehgal: Vipin.

Vipin Jain: Yes, we had given guidance last time that the average capex for the next three years are going to be in the range of €250 million, this is the average capex for the next three years.

Nitij Mongal: Okay, thank you.

Operator: We have no further questions on the line.

Vaaman Sehgal: Okay, I guess those are all the questions that you have. We're always available. The presentation has been uploaded to the website and the investors are always free to ask us questions through the website as well. We thank all of you for joining the call and for your continued support and look forward to speaking with you the next quarter. Thank you very much.