

“Essel Propack Q1 FY17 Earnings Conference Call”

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PROPACK**

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MODERATOR: **Mr. Dhaval Mehta - Research Analyst, Emkay Global**

Moderator:

Ladies and Gentlemen, welcome to the Q1 FY17 Results Call of Essel Propack hosted by Emkay Global Financial Services. As a reminder, all participant lines are in 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’ on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Dhaval Mehta – Research Analyst of Emkay Global. Thank you and over to you, sir.

Dhaval Mehta:

Thanks, Ali. Good afternoon, everyone, and welcome to the Q1 FY17 Earnings Con-call of Essel Propack. We would like to thank the management for giving Emkay the opportunity to host this call. From Management we have with us Mr. Ashok Goel – Vice Chairman and Managing Director, Essel Propack, along with Senior Management of the Company. We will start with the opening remarks by Mr. Goel, followed by Q&A. Over to you, sir.

Ashok Goel:

Thank you, Dhawal and Emkay for hosting this conference. Ladies and Gentlemen, welcome again to the first quarter financial results of Essel Propack. During the first quarter of the financial year, the consolidated revenue of the continuing business grew year-over-year by 3.5% to Rs.528 crores. Adjusted for the impact of raw material prices pass through in the wake of fall in commodity prices, the underlying revenue growth for this period is 5.5%.

India business, after a sluggish year and half is now showing signs of recovery, posting a year-over-year underlying revenue growth of 9% after factoring the raw material price pass through impact estimated at 3%. It is heartening to have the non-oral care category in this key market, growing at high double-digit. On the other hand, the market outside India disappointed with an underlying year-over-year revenue growth of just about 2.4%. The silver lining here was that our small operations in the developing

markets like Mexico, Russia and Philippines have performed well above the budget posting healthy revenue growth.

Admittedly, the first quarter for us has always been low key in terms of sales but the impact this time of the pipeline stock correction by key customers in US and Europe and the continuing slide in the oral care off-take of our key customers in China has been sharper. While some offsetting was achieved in China and Egypt through stronger non-oral care sales, overall, the sales growth was below our target. The non-oral care share in revenue declined to 40.5%, impacted mainly by US and China.

The lower revenue growth has caused the EBITDA margin to drop by 60 basis points to 18.5%; the margin impact is felt most in Europe at 3.5% and EAP at 1.5%. Improved efficiency and costs management have helped Americas and AMESA improve the margin by 40 basis points. Finance costs have reduced by 28% with net debt contained at Rs.667 crores and reduction in the average interest rate by 150 basis points compared to previous year. Consequently, profit after tax posted 6.6% growth to Rs.37.6 crores. Balance sheet continues to be strong with debt equity ratio at 0.77, ROCE at 17.8% and ROE 20% on trailing 12 months' basis.

Taking stock of our mission 20:20:20, we are confident that the business is on track to drive our performance through improved sales growth of around 12% in the coming months for various reasons. And the reasons are: One, Indian FMCG demand shows clear promise and we have contracted significant volume which is under ramp up. Investment in capacity expansion in India is progressing well, in fact, a world-class facility has been commissioned in western India to replace the Silvassa unit which could not support the expansion. Both these units that we are discussing i.e. the new western India unit as well as the Silvassa unit, work on leased properties. The new plant is built to suit our requirements. The growth in India is coming both in oral care and non-oral care with a number of new customer wins in the pharma and cosmetic categories. We have also widened our range of product offering to the non-oral care category, pioneering state of the art decoration and large dia SKUs. In fact, to meet the contracted demand in plastic tubes, India would be investing in a line to be relocated from Poland.

The other reason is, the new product development pipeline, especially for non-oral care is quite full and is in different stages of implementation in China, Europe and US. Although the ramp up has been slow, we see commercialization to pick up in the

coming months. The third reason, our new facility in Colombia is stabilizing after initial teething problems. The demand, especially for the non-oral care is buoyant in this market and should deliver strong sales growth during rest of the year. The fourth reason for our belief that we will continue to perform better, is that customer engagement continues to be strong and we are looking to contract further volumes including with the leading oral care brands in different geographies, leveraging our capacity and new capabilities. We have invested for growth in Europe and expect the growth to resume driven by non-oral care.

With the sales growth normalizing, the margins and PAT growth should fall in line with our strategy. We are happy to share a new breakthrough that we have achieved in inventing a robust and innovative laminated tube solution for use in hair colorants and color developers. This was a major technical challenge, considering that these products tend to be aggressive; on the other hand the customer is looking to such innovative solutions, given the supply continuity issue posed by use of toxic chemicals in the existing packaging solution. This should open up a huge growth market of approximately 2.5 billion tubes globally and further accelerate our growth through expansion in the non-oral care category.

To sum up, we recognize that the recent quarter is not the best that we can deliver, that our strategy is intact and the on ground situation is still as conducive to support and nurture a profitable growth envisioned in our mission 20:20:20.

Now , just few a housekeeping points that I must highlight ; hitherto the company was following Indian GAAP for accounting; now from this quarter, we have changed to IFRS, i.e. IndAS; the impact of that is the sales reduced by around 2.7% on account of a joint-venture being required to be accounted as associate and included only for profits. Now just to clarify, this 2.7% impact is for both comparable periods, in that only thing is the denominator changes. And then the second impact is the profit after tax is impacted by around 5% on account of fair value provisioning of employee stock options and certain other changes with respect to deferred tax computation.

So, with that I will open the floor for questions.

Moderator:

Thank you very much. Ladies and Gentlemen, we will now begin the question-and-answer session. We will take the first question from the line of Nihal Jham from Edelweiss. Please go ahead.

Question and Answer Session

Nihal Jham:

My first question is related to the non-oral care growth in EAP and China, if we look at it, the growth was around 40% till H1 and after that it has marginally slowed down. So what is our expectation of non-oral growth for this coming year? And if you could also share the year-on-year growth, because I think we are seeing 7% it has grown sequentially?

Ramasamy:

See, non-oral care in EAP is not slowing down, basically we have tried to catch up non-MNC oral care customers in EAP that growth has started coming in. So, percentage wise it looks slightly different but our efforts to continue to grow on non-oral care is on and as we go along we will see the result of those efforts.

Ashok Goel:

Does it answer your question, Nihal?

Nihal Jham:

And sir, I was looking for the year-on-year growth this year in non-oral in China.

Management:

Nihal, now you would recall that in China we had moved up to almost 27.5% share of non-oral care, right.

Nihal Jham:

Absolutely.

Management:

And then the last two quarters, December and March incrementally it was not coming up. So, what we are stating now is that sequentially our non-oral care growth has moved up by 7%, in the sense that we are getting other customers; you would recall we had explained to you about a couple of customers where they had an issue in the market place and now, in the interim while they bounce back, our customer development continues and therefore that has helped us during this quarter to sequentially improve. But compared to the last year when we actually peaked in non-oral care there, we have actually declined.

Nihal Jham:

And sir, my next question is basically on the European operations, there as I see that there has been a slight dip in our revenue growth as well as margins and we have mentioned that mainly in US as well as Europe it is mainly an issue related to inventory correction that has happened by the customer, so we should expect that in the coming quarters that should turn around and we should get back to our normal trajectory, right?

Ashok Goel:

Yes, you are right Nihal. Europe is because the volumes were below our thresholds so it also impacted the margin percentage. But as we pick-up the volume, that should correct itself. US is a similar situation where the inventory correction by the customer is over and the demand is coming back up again. In fact, with one of the customers, effective fourth quarter we will have 15% increased volumes coming in which should be about 10% or maybe a little less than 10% of US revenues. So, yes we are quite hopeful. Coming back to your question on China, I will explain what Ram just said. Let us understand that in China in the last two years as per the AC Nielsen data, the oral care market has shrunk by 4% and the MNC brands probably have lost more than 4% market share. So, where is the difference? The difference is picked up by the local brands. While we have some of these customers with us, some new customers are being contracted and the trials are on. And therefore while we may not recover the full volumes, there will be recovery in oral care in China.

Nihal Jham:

And sir just one last question, you had given a guidance of 12% to 15% growth that we are looking for this year, do we still look at that growth for coming year?

Ashok Goel:

Yes, we will, 12% is for the full year we will achieve. And in fact this time, India is leading the growth vis-à-vis last year when India was struggling as the economy was struggling. So, we are seeing higher growth in India.

Moderator:

Thank you. We have the next question from Dimple Kotak from SKS Capital. Please go ahead.

Dimple Kotak:

Sir, as you said the 12% growth will be taking due to ramp up in your facilities in India and since you are bringing in the world-class facility and taking new customers, but by when would this happen, will we see this in Q4 or how is the next quarter panning out for us?

Ashok Goel:

Dimple, when we say the growth we talk about the annual number, quarter-on-quarter number varies hugely for different reasons.

Dimple Kotak:

Yes sir, but I believe the ramp up, the effect of that should be likely in the second half of this year, or are we seeing this was the weakest quarter and from next quarter we see good growth numbers coming back on track?

Ashok Goel:

Yes, June is always the weakest quarter, Dimple, for us. And we expect that some improvement will be in September quarter and better improvement in DQ and MQ.

Dimple Kotak:

And sir, the new facility which you are setting up in the western India, when that will that be operational full-fledged?

Ashok Goel:

There are two parts to your question, when will that be operational and the next is operational full-fledged. So, second part I cannot answer; first part I can certainly answer - that it is already operational and the capacities from Silvassa have been shifted to that plant completely.

Dimple Kotak:

And sir, what is the utilization levels like?

Ashok Goel:

Utilization of this particular plant?

Dimple Kotak:

Yes.

Ashok Goel:

This particular plant as of now would be low which typically happens for any new facility, but then it takes couple of months.

Dimple Kotak:

And sir overall, overall as a group what were the utilization levels?

Ashok Goel:

Utilization, you guys typically look at what is the head space; so we do have some head space, for example in Poland. India we are actually falling behind in capacity so we are constantly adding capacities. And Colombia we have added capacity but initial teething troubles will be over and we will have increased volumes.

Dimple Kotak:

That, as you mentioned from Q4 onwards?

Ashok Goel:

No, that will happen from this month onwards. That unit will start to deliver and therefore it will achieve the annual numbers.

Dimple Kotak:

And sir, how is the European market looking like? Because I think in the previous calls also you said that that is one of the major growth figures for you going ahead, so how are they panning out because this year I agree the inventory correction due to that we had bad numbers, then whatever did in the coming year if you can just throw some light.

Ashok Goel:

So, Europe continues to be our growth focus because that is one geography ,for multiple reasons , where the competition is weaker and therefore there is opportunity for us to grow in that market. Second, because the overall volumes in Europe for us is lower and therefore the economies of scale, we need to achieve and for that we would push more growth in Europe and we see that our efforts are going in the right direction.

Moderator:

Thank you. We have the next question from the line of Abhishek Agarwal from CD Equisearch Private Limited. Please go ahead.

Abhishek Agarwal:

Sir, I want to understand the sharp dip in the EBIT margins in the EAP region, as last to last quarter we saw operations stat out very well in the EAP region.

Ashok Goel:

Yes Abhishek, so let's look what constitutes of EAP in this particular case; it is China and Philippines. Philippines is actually growing strong double-digits but it is a very small unit. China, as I already explained, we have grown in non-oral care but that growth is not enough to offset the drop in oral care.

Abhishek Agarwal:

Sir, your market share in China in non-oral care?

Ashok Goel:

Non-oral care market share would be miniscule everywhere, not just in China.

Abhishek Agarwal:

Sir, and your market share and if you look at globally your market share in non-oral care, as in oral care you have 36% as you say, in non-oral care?

Ashok Goel:

Non-oral care we would be anywhere between 3% to 5%.

Moderator:

Thank you. We have the next question from the line of Andre Purshottam from Cogito Advisors. Please go ahead.

Andre Purshottam:

I want to know what is the level of confidence you have in increasing the share of non-oral revenue in the foreseeable future? Basically, let's say one year down the line or let's say three years down the line what do you expect the share of business to be? And is the appreciable change from what it is today, what would drive this change?

Ashok Goel:

So Andre, our objective of 50% revenue coming from non-oral care remains intact and all our efforts, investments, everything continues to move in that direction and that will continue to happen. There are multiple ways that we are going to achieve. When we talk about non-oral care what are the categories we talk about? We talk about beauty and cosmetics, we talk about pharma and health, we talk about food and homecare. So, obviously there are multiple avenues for non-oral care growth to come in. We just announced today that we have a new innovation breakthrough whereby we have developed tubes which can be used for hair colorant and color developers, and that has

a market opportunity of 2.5 million tubes globally. So, there are multiple pieces of the non-oral care strategy and we are totally confident and our front end teams and back end teams are all geared up to achieve that objective. So, we do not see any weakness in that.

Andre Purshottam:

So, do you see that objective being achieved in a year's timeframe or a three years' timeframe or a two year timeframe?

Ashok Goel:

We said two to three years, so in this quarter , okay it has dipped but it does not mean that it would remain dipped for the full year and in this year we expect that we should be doing better than last year - last year I think it was 42%.

Andre Purshottam:

And do you see the non-oral care growth coming from across all your regions or will some regions lead the growth?

Ashok Goel:

That I have been saying in the previous calls, we have two strategies - uphill to downhill and downhill to uphill - which means that for beauty and cosmetics we are first focusing, of course all efforts go in every geography , to change the packaging format in the developed market which is Europe and US, and in the emerging market we increase our focus on pharmaceutical and then on to developed markets. So, this way we are moving and that strategy is working well.

Moderator:

Thank you. We have the next question from the line of Kumar Soumya from Wealth Managers. Please go ahead.

Kumar Soumya:

Sir, my first question is regarding, I heard you in an interview, you said that R&D expense is around 3% on materials, but in annual report we see just 1% we spent on the R&D. So, could you please explain that?

Ashok Goel:

You are right, whenever I said we spend about 3% on R&D, I have also qualified that by saying that we do not have a perfect system of capturing that spend very correctly as R&D expense. So, therefore most of it goes into revenue expenditure and we are working on fine tuning a system whereby we capture all the costs related to R&D as R&D expense.

Kumar Soumya:

And sir about our High 5 Mission how far do we expect it to capture or achieve this target of High 5 Mission that we set out in 2013, I guess.

Ashok Goel:

So, I think after Mission High 5 we said 20:20:20, which was an improved version of High 5 where we said 20% ROCE, 20% ROE, 20% EBITDA margins, 15% top-line growth, 20% bottom-line growth. We are confident, just do not get disheartened by this quarter's numbers and they are optically illusionary, underlying business has grown 5.5% so there is no reason for us to be disheartened.

Kumar Soumya:

Sir one more question, sir these products that we have that includes caps and closures dispensing systems, so what is the quantum in that segment like for caps or dispensing of laminates?

Ashok Goel:

See, caps we do not sell to any third party, all caps we make is for in-house consumption and that is already factored into the revenue of the tubes because that goes along with the tubes.

Kumar Soumya:

Laminates also, sir?

Ashok Goel:

Laminates, most of it is the internal sales again which gets eliminated in the revenues. And part of it we do sell to third parties which is not significant.

Kumar Soumya:

And sir, dispensing system that tubes we have, so isn't this is a hair tube that we talked about goes into that dispensing system?

Ashok Goel:

No, dispensing system actually means the design of the neck and the shoulder, for different product applications there are different neck and shoulder and sometimes it also pumps, sometimes it has inserts, sometimes it has roll-on balls, sometimes it has a sponge etc. So, those are what we call dispensing systems which is an integral part of the tube.

Kumar Soumya:

And sir, I think the restatement that we have done to IndAS from Ind-GAAP, sir in the segment section we see all the segments are restated as it is excepting Europe session where we have seen from Rs. 93 crores to Rs. 78 crores, so can you please explain that sir?

Ashok Goel:

Yes, first of all it is from I-GAAP to IndAS and not the other way around as you said. Europe, because Germany is our minority share joint venture where Essel Propack holds minority equity, is now classified as associate and not as a JV, and therefore we had to eliminate under the IndAS the revenues line by line item, we have only captured the share of profit in that.

Moderator:

Thank you. We have the next question from the line of Bobby Jairam from Falcon Investments. Please go ahead.

Bobby Jairam:

Three questions, the first one, could you elaborate on how you recognize revenues? Is it that your customers contract for two or three years and then they dictate the volumes every quarter which is what is booked there? That is the first question. The second question is, what is the ROIC you aim for in your global plans, is there an absolute minimum? And number three, given that your market share for non- oral care is at 3% to 5%, it assumes that there must be pretty strong incumbent, how are you getting share from that?

Ashok Goel:

Bobby, I think your voice broke a little bit so I have not clearly understood your question, so let me go as I have understood. On revenues you are asking does the customers provide us the tool and we redo the job work, is that the question?

Bobby Jairam:

The question is, you supply to customers on long-term contracts, correct, two to three years contract?

Ashok Goel:

In case of oral care, yes.

Bobby Jairam:

And the revenues are recognized by the volume that goes in each quarter which depends on the customer directions, correct?

Ashok Goel:

Revenues are recognized as we dispatch the tubes under those contracts, yes.

Bobby Jairam:

So, let us say if it is 100 tubes your customer orders, it could be 20 one quarter and 15 the other depending on what do your customers ask?

Ashok Goel:

Yes.

Bobby Jairam:

So, that is the same way it is for non-oral care?

Ashok Goel:

Yes.

M. R. Ramasamy:

So, all our revenue recognition, Bobby, happens on the basis of the dispatch, actual sales effected, be it oral care or non-oral care. So, even if we have a contract for certain volume for the year, I will be recognizing sales based on what I actually dispatch and invoice the Customer.

Bobby Jairam:

So, the customer actually tells you beforehand how much to be dispatched in a particular quarter?

M. R. Ramasamy:

That is right.

Bobby Jairam:

That is what causes the variability quarter-to-quarter?

Ashok Goel:

That is right, yes.

Bobby Jairam:

The second question was, what is your minimum return on invested capital that you look forward when you open a global plant?

Ashok Goel:

Our minimum threshold on return on capital employed - 20% is what we are aiming for. But we also reckon that anytime we do new investments then it has a minimum threshold which is 16.5% is what we begin with, because we know that initially the costs are high but ultimately we will inch up to 20%.

Bobby Jairam:

So, you are very much focused on return on capital, if not just going all over the world?

Ashok Goel:

Yes. You are absolutely right.

Bobby Jairam:

The third question was, given that you have a miniscule share for non-oral segment which you just mentioned, a 3% to 4%, how are you actually breaking in to the territory of incumbent, what is your edge here?

Ashok Goel:

In non-oral care our edge is, so I need to explain what are the things that we are working against, so to speak. So, one is aluminum tubes, second is plastic tubes, third is bottles. Aluminum tubes, we all know aluminum itself is a strong barrier by itself, but is also a soft metal which reacts with anything that it comes in contact with. And therefore aluminum needs to be coated with certain industrial grade coatings to avoid any reaction with the product that is filled inside. And the fact that those are industrial grade coatings has its own disadvantages in terms of compliance with the health and safety regulations across the globe. So, therefore that is one plank that we have laminated tubes which are specifically designed and the fact that we call it laminated tubes, it means that it has a laminate; a laminate has multiple layers which can go from let's say 12 layers to 23 layers. And why different layers? That is designed to suit specific products that go inside the tube - so that it does not react with the inside of the tubes and does not escape outside of the tube - and the atmospheric elements do not attack the product inside. So, that is called barrier properties. So we design those barrier properties. In case of plastic tubes, plastic tubes can have maximum of five

layers which has its own limitation in terms of barrier properties, thereby the brand owners have to tweak their formulations because those layers do not provide enough barrier properties thereby allowing certain components of the product filled inside to escape. Therefore the brands, to give the promised experience, have to overdose certain contents, for example fragrance as discussed in this example. So, fragrance escapes, so the brand owners have to overdose the fragrance so that the consumer has the desired experience. Now, in case of laminated tubes they do not have to do that because we can customize the properties. And of course, the decoration we can do much better than what was available for plastic tubes, That is the innovation that we have brought in. Bottles being heavy and the fact that in bottles, even after the so called full consumption, there is still material left ; so consumer does feel in that sense that they have wasted the material and the fact that it consumes more weight of plastics and thereby we believe laminated tube is the option. So, these are the three major planks that I can say that we believe make our non-oral care play sound and solid.

Moderator:

Thank you. We have the next question from the line of Ritwik Sheth from Span Capital. Please go ahead.

Ritwik Sheth:

Sir, I had a few questions. Sir, firstly on the new invention Mystik you mentioned that it is a 2.5 billion tube market for that product, so can you give me that in value terms?

Ashok Goel:

Ritwik, you always put a googly.

Ritwik Sheth:

Just wanted to gauge what kind of market are we getting into, I am sure it will be a value added market.

Ashok Goel:

Yes, it is value added. Hair colorant sells across the globe and you already know the same tube I sell in India sells at 2.5 times in US. So, depending on where I get the conversion, that is the value that I will derive. So, therefore I say it is a googly.

Ritwik Sheth:

And this is for across the globe or only for India?

Ashok Goel:

Across the globe, we always talk global.

Ritwik Sheth:

Okay, 2.5 billion globally?

Ashok Goel:

Yes.

Ritwik Sheth:

And going forward low commodity prices, are they factored into the base from now onwards or there is still light for a quarter or two?

Ashok Goel:

If you are asking related to revenues?

Ritwik Sheth:

No, not revenues, I am saying that you mentioned that underlying growth is 5.5% but at some point of time the base will also be lower than it will be comparable and...

Ashok Goel:

So, we still have one more quarter on the revenue side.

Ritwik Sheth:

And just, depreciation will be similar to FY16, for the current year, around Rs.125 crores - Rs. 30 crores?

Ashok Goel:

It may be around Rs.140 crores to Rs.150 crores.

Ritwik Sheth:

And interest cost for the year we can annualize at the current quarter because significantly we are reducing interest cost?

Ashok Goel:

Yes, more or less.

Ritwik Sheth:

And sir, one last question, taking a step back seeing that in the last three to four years we have done exceptionally well from profit of less than Rs.60 crores to around Rs.180-plus crores in FY16. So, would you say that we have already taken all the low hanging fruits and now going forward incremental growth will come from higher share of non-oral care and all the new innovation like Mystik and all that?

Ashok Goel:

It will be a mix of things, majority of low hanging, yes they have been plucked, there are still some low hanging fruits, I cannot talk on openly, we are working on. And so I think we still have about little over a year from now to pluck all the low hanging fruits.

Ritwik Sheth:

And our focus remains on the non-oral care part and in that pharma and cosmetics, etc.?

Ashok Goel:

Absolutely, while we constantly look for growth in oral care as well, yes.

Ritwik Sheth:

And sir just one final question I wanted to say, you mentioned in the investor update that one Chinese guy you are planning to off-take with them also. So, what kind of, if you can share some kind of revenue potential possibility?

Ashok Goel:

So, right now I am looking at arresting the de-growth in oral care for me in China.

Ritwik Sheth:

That is a first priority?

Ashok Goel:

Yes.

Moderator:

Thank you. Our next question is from the line of Ankit Gaur from Systematix Shares and Stock. Please go ahead.

Ankit Gaur:

It is heartening to see India growing, but my question regards to India's oral care market, is it de-growing or how it is, if you can highlight that. And in that perspective only, you said that pharma and FMCG is doing good, so pharma categorically it is OTC or prescribed again there?

Ashok Goel:

So, oral care market in India we believe is growing at about 3% to 4% at the moment; it can grow faster if the overall macro economy does well. Therefore we do not believe that the market in India is sinking at all, it is on the contrary, growing. It is growing less in the urban areas and more in the rural areas and that pretty much follows the macro economic situation. As far as pharma is concerned, we sell tubes for both prescription and over the counter products.

Ankit Gaur:

So, we actually added new customers in FMCG and pharma side right, so I just want to recheck this, we have been facing some of the regulatory issue with regards to prescribed drugs, more or less we have covered entire OTC market on Indian perspective. So, how we are placed in that part of a business when it comes to prescribed drugs?

Ashok Goel:

We are compliant wherever we are getting; our manufacturing facilities are pharma approved facilities, certified rather. And I think Roy Joseph, who is AMESA business head will explain.

Roy Joseph:

So, we are doing OTC as well as prescription; OTC conversions have happened faster in our time for approvals. What we see in terms of growth are on prescription side. So, in terms of facilities, we have a clean room facility, we are certified by our customers and also by independent agencies. And we also do export some of these to the regulatory markets e.g. ophthalmic products. which are again prescription products.

Ankit Gaur:

And sir my last question with regards to Chinese economy, if you can share the capital capacity utilization in China given that we have a year or year and a half that we also setup a new plant in China, so what is the utilization level in overall sense there?

Ashok Goel:

Sorry, Ankit, could you repeat that question related to China?

Ankit Gaur:

Sir, I want to know the utilization levels in China, considering that oral care is de-growing and non-oral care catching place slowly and steadily. And China would be the second largest base post India, we have around five to six facilities in China right, correct me if I am wrong there.

Ashok Goel:

Yes, five facilities.

Ankit Gaur:

So, what is the utilization level in China and what is the game plan there? Considering you already mentioned that oral care is slowing down there and your focus would be

more on non-oral care side of the business. So, if you can share the utilization level there.

Ashok Goel:

Let me answer the second part of the question. We have not given up on oral care, it is just that we have to get more customers who are selling more currently and those customers are local Chinese brands. Why local Chinese brands? Because they are based on the traditional medicinal toothpaste, which by the way, unlike India, is more premium than the MNC brands. In India, we see Patanjali selling at a lower price than the MNC brand; in China it happens the other way around. And while we were strong with MNCs, we were not absent with the local brands ; we are strengthening our relationship with the local brands and have won some business which we are already supplying. Some new business we have contracted where the trials are on and we expect that business to come. Therefore we are saying that we are focusing both on oral as well as on non-oral in China.

Now the first part of your question is capacity utilization. Obviously there are capacities which are dedicated to some customers and there are capacities which are inter-changeable. So, the capacities which are dedicated, there we might be utilizing low because if that customer does not give me the order I have that capacity idling; though we have freedom to use that for other customers but the geography may not be the right one. And in some other location where the capacity is really inter-changeable, there we are trying to fill up with the local brands. So, overall I would say my utilization at the moment would be about, if you are looking at head space there, is about 8% headspace.

Moderator:

Thank you. We have the next question from the line of Kumar Soumya from Wealth Managers. Please go ahead.

Kumar Soumya:

Sir, I just have a couple of more questions. So, what is our target capital structure we are aiming for?

Ashok Goel:

What do you mean by capital structure?

Kumar Soumya:

What is the ideal debt to equity that we are targeting or we are comfortable with?

Ashok Goel:

I think the current level we are comfortable and anything more favorable, more towards equity and less towards debt can be counterproductive. Therefore we believe that this level is good. Now the next obvious question you will ask me is then what will you do with cash.

Kumar Soumya:

Yes, sir.

Ashok Goel:

Then obviously we will probably look at expanding the business much faster than we have, or if we are still left with cash then we will find ways to reward the shareholders.

Kumar Soumya:

Sir, do we have the numbers for oral and non-oral segments that we have?

Management:

I will just give you the share of non-oral care, AMESA is 50%, EAP is 25.5%, Europe it is 55% and Americas is 23%.

Kumar Soumya:

Sir, one last question, the pharma category we talked last time we had 80 customers, so have we added any more in there?

Ashok Goel:

I don't know where that came from - 80 customers, I do not know whether it is a global or Indian.

Kumar Soumya:

It is a total I guess 80 customers that we have currently.

Ashok Goel:

I am sure we have added more, now the count obviously I do not have.

Moderator:

Thank you. We have the next question from the line of Srinath M from Motilal Oswal Asset Management. Please go ahead.

Srinath M:

I mean, just looking at the geographical numbers there is a correlation between revenue and EBIT both in terms of direction and magnitude in most geographies. Except Europe where actually revenue is up 5% even adjusted for raw material pass through and all that, but EBIT is down sharply. So, is there an explanation for that?

Ashok Goel:

Yes, Srinath. First, we have added more capacity than what we have actually sold in this quarter, and obviously even though the revenues are higher than last year, the mix also might have changed; the oral to non-oral and within that lower diameter, higher diameter and all those combinations. So, if the mix is not favorable that also can change.

Srinath M:

Can it be so adverse as to bring down EBIT in absolutely terms, I mean, margins I can understand but absolute EBIT is down 57% on a sales growth of 5% that was the number suggested.

Ashok Goel:

Yes, so it has to be seen in combination, not just the product mix. Also, because we have added capacity we have added more number of people which has gone idle for the first quarter and that would have double impact.

Srinath M:

So, Europe seems to be off and on in terms of the strategy, sometimes seems to be on a secular revival path and suddenly it is pushed back again. So, what is the sense, I mean, again we are relocating one line from Europe to India, so what is our Europe strategy?

Ashok Goel:

I think you are reading those statements in isolation. Let me answer the line relocation from there to India. I have also said that we have shifted the capacities from plastic tube capacity from US to Poland and so we shifted one earlier machine which has different capability, shifted another one which has different capability. Now, the one which came in last is under commissioning and that is the capability they actually need for their business, and the one that therefore they can release and which is in line with our strategy to sweat our assets; and because we have contracted more business in India obviously we need capacity in India. So rather than investing afresh in buying a machine from outside we are sweating it inside and bringing that to India. That does not mean the business is shrinking in Poland. It is just that we are realigning the capabilities of those equipment and use them where they are needed. Second – yes, it is a temporary blip. First quarter generally is soft, this has been softer than we have expected. So there is nothing for us to get really alarmed about it and as I said, somebody asked previously in this call, our strategy for European growth is intact because we have to get the economies of scale in Europe to a better level. And we have a couple of actions, while the actions on the ground are there for them to improve the current capacity utilization, we have a few more actions that we are going to take at a corporate level to accelerate the growth in Europe.

Srinath M:

So in Europe, as Ganesh just gave the numbers, our non-oral care is already 55%, right, is that correct?

Ashok Goel: That is right.

Srinath M: Which means we are there in terms of the oral, non-oral care mix also there, but it must be largely plastic tubes rather than laminate tubes, that could be one reason?

Ashok Goel: In Europe actually it used to be reverse. Europe we were 80% non-oral care and we desperately wanted it to be in the middle path, because oral care does give the economies of scale.

Srinath M: And again speaking about Europe, again just partly a house keeping question kind of thing, Europe liabilities for example, segment liability, we are showing a negative number, how should we read that? From Rs. 47 crores we are looking at

Vinay Mokashi: Actually, that is regrouping as mentioned earlier where our Germany joint venture, which was earlier accounted line by line on proportionate consolidated basis, has been accounted on equity basis, so there has been a regrouping from that line to another. **Srinath M:** I get that but negative liability, what does it mean, we are working on negative working capital, I mean liabilities I can understand a lower number or whatever, but when a liability becomes a negative number which means it is actually difficult to interpret. In normal cases it would mean negative working capital which is advance from customers, say a FMCG company or whatever, liability could be negative, but negative number, how do I interpret it, I am trying to understand.

Vinay Mokashi: We will check and come back on this.

Srinath M: And the last question, again partly accounting related. There is a swing in this other comprehensive income which is the new IndAS norm, so is there a brief explanation for that?

Vinay Mokashi: The OCI?

Srinath M: Yes, OCI.

Vinay Mokashi:

See, as per the accounting standard when you consolidate the subsidiaries, you consolidated the closing exchange rate. So, the difference is normally held in the balance sheet as a foreign currency translation reserve, and under new IFRS it requires to be shown and routed into the balance sheet through other comprehensive income; that is why you will see this movement but it is basically reflecting a balance sheet movement.

Srinath M:

But there is a swing in it, I mean, last quarter it was a positive Rs. 10 crores, this year it is negative.

Vinay Mokashi:

That is right, because what happens at every closing is you are revaluing the balance sheet at the exchange rate, so therefore that valuation movement has to come through this.

Srinath M:

This is largely translation

Vinay Mokashi:

Yes, it is only translation and nothing else, which is to be carried as a balance sheet in the equity.

Moderator:

Thank you. We have the next question from the line of Nihal Jham from Edelweiss. Please go ahead.

Nihal Jham:

Just one question from my side. For Mystik do we have any specific sales target for this year and next year?

Ashok Goel:

Not factored in, Nihal.

Nihal Jham:

Do we expect it to be significant, especially for this year, I know next year may be little too far but at least in this year we expect it to be any significant?

Ashok Goel:

Not really, except for some we have had. It is not very significant for this year, Nihal, - not huge numbers.

Moderator:

Thank you. As there are no further questions from the participants, I now hand the conference over to Mr. Dhaval Mehta for closing comments.

Dhaval Mehta:

Yes sir, a couple of questions from my end. Sir, Mystik , basically it will be targeting the hair color segment, so is there any particular geography where you are focusing more for this particular product?

Ashok Goel:

Dhawal, this has been our focus. We have been working on this product for last two and a half - three years and we have tried various methods to overcome the challenges that this product poses. And in the meanwhile , we have obviously spoken to many customers in almost all geographies, almost every geography rather. So what happens is you need just one customer to lead it and that will happen. By the way, just for everybody's knowledge, if it was Essel Propack alone who had this product, the chances are we will not get the commercialization of it because the brands would want an alternative supplier. And therefore we believe that our competitor also has found a

solution, one global competitor. And if two suppliers can offer this product then the conversion can happen faster and therefore we are very confident.

Dhaval Mehta:

Sir, and the second question is on the EAP region, as you have mentioned in your commentary that you are looking at a breakthrough with one of the top Chinese oral care brand, so has the numbers been factored in in this particular year or it is totally a new contract?

Ashok Goel:

It is a new contract, but factored in for the budget of the EAP, China.

Dhaval Mehta:

Okay sir. Thanks a lot sir. And once again, thank you for giving us the opportunity to host this call. Sir, would you like to make any closing comments, sir?

Ashok Goel:

Thank you very much, Dhawal and Emkay Globals and Thank you again Ladies and Gentlemen. Srinath, you have one question, we will take that offline and answer that for you. So thank you very much.

Moderator:

Thank you. On behalf of Emkay Global Financial Services that concludes this conference call for today. Thank you for joining us and you may now disconnect your lines.

Note: 1.This document has been edited to improve readability.