"CEAT Limited
Q2 FY2020 Post Results Conference Call"

October 23, 2019

ANALYST: **MR. ANNAMALAI JAYARAJ – BATLIVALA & KARANI SECURITIES INDIA PRIVATE LIMITED**

MANAGEMENT: **MR. ANANT GOENKA - MANAGING DIRECTOR – CEAT LIMITED**
MR. KUMAR SUBBIAH - CHIEF FINANCIAL OFFICER – CEAT LIMITED

Moderator: Good morning ladies and gentlemen, welcome to the CEAT Limited Q2 FY2020 Post Results Conference Call hosted by Batlivala & Karani Securities India Private Limited. 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 the operator by pressing "*" then "0" on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Annamalai Jayaraj from Batlivala & Karani Securities. Thank you and over to you, Sir!

Annamalai Jayaraj: Thanks Lizaan. Good morning everyone. On behalf of B&K Securities, welcome to Q2 FY2020 Post Results Conference Call of CEAT limited. We have with us today Mr. Anant Goenka, Managing Director and Mr. Kumar Subbiah, Chief Financial Officer. I will now hand over the call to Mr. Anant Goenka for the opening remarks to be followed by question and answer session. Over to you, Sir!

Anant Goenka: Thank you Jayaraj. Good morning everyone and a very warm welcome to CEAT's Q2 FY2020 earnings call. I am Anant Goenka and I have with us our CFO, Kumar Subbiah here with me.

I will share some financial and operational highlights for the quarter and the first half gone by to be followed further financial commentary by Kumar. The floor will then open for questions.

With respect to Q2 performance with the prevailing demand slowdown for OEMs as well as overall weak consumer sentiment this was a challenging quarter for us from the topline perspective. On a standalone basis, revenue for the quarter declined by 5.2% on a year-on-year basis and 3.4% sequentially. This is primarily on an account of volume decline both year-on-year and Q-o-Q.

At an overall level, our volumes sequentially declined by 3.1%, and this were largely on an account of slowdown in the CV segment. Our passenger segment, which is passenger car, SUV and two-wheeler continue to perform well and show healthy sequential and year-on-year growth across both the replacement and OEM segments. This also helped our improved margin profile. Our gross margin expanded by 220 basis points sequentially and reached 40.7%. Similarly, our EBITDA margin expanded by 95 basis points sequentially and reached 10.4% after trailing in the sub ten-region for the last few quarters.

Some other highlights for the quarter go by with respected to OEMs, we continue to make good headway with both existing and new OEMs. The new festive season launch of Maruti their Espresso model in on CEAT cars. We are also present in the Renault Kwid Refresh as well as the Renault Triber. The Hyundai i10 is also on CEAT tyres. On the two-wheeler segment 2 we had various new entries. The new Pulsar 125 and the Suzuki Access 125 are both on CEAT tyres. We also gained entry into all variants of Honda Bikes till 125 cc, Yamaha FZ 150 cc and Suzuki Gixxer 150 cc. Over the past years, CEAT has developed strong brand equity in the market and we continue to invest to ensure sustained and improved brand recall.

CEAT became the associate sponsors of the latest season of Kaun Banega Crorepati as well as the latest season of Indian Idol. We also be associates sponsors of Big Boss Tamil, which gives CEAT improved visibility same regional markets. Our association with cricket continues and got further strengthened as we welcome Shreyas Iyer into the CEAT family. Shreyas will be sporting the CEAT bat across all formats of the game. We also had a large current launch. We launched a new X3 truck tyre range at a pan India level. This has been one of the largest launches in the truck segment in many years for CEAT and this will help substantially strengthen our product perception and increase sales in the truck radial segment going forward. I like to handover the call to Kumar on our financial summary.

Kumar Subbiah: Thank you Anant. Ladies and gentlemen, thanks for joining our Q2 FY2020 earnings call. I will now present some key financials.

Our consolidated net revenue for the quarter stood at 1692 Crores, a decline of about 4.6% year-on-year and 3.5% sequentially. The decline in revenue was largely on an account of drop in volumes; however, our net realization remained at the same level as the previous quarter. Our consolidated gross margin for the quarter was 41.1%, an improvement of 160 basis points quarter-on-quarter and 120 basis points over the same period of previous year. The improvement in margin was largely on an account of better product mix, lower raw material cost and movement in finished goods.

Let me cover our key movements in operational expenses. We kept tight control our operating expenses during the quarter. The employee costs were lower due to level of performance bonus and lower provision for leave encashment related provisions. Other expenses for the quarter was little on the higher side largely on an account of higher level of production versus previous quarter. We maintained our marketing cost inline with previous quarter. Our depreciation was higher for the quarter due to progressive commissioning of our project assets and interest cost was higher due to increase in our borrowing.

As approved by the board and the shareholders during the quarters, we distributed a dividend of about Rs.12 per share involving a cash outflow of Rs.56 Crores. The standalone profit and loss includes about Rs.10.3 Crores of dividend that we received from our subsidiary in Sri Lanka. Our consolidated EBITDA for the quarter in absolute terms was Rs.175 Crores translating to 10.4% of revenue, an improvement of 110 basis points for Q2 of the previous year and 60 basis points higher over the previous quarter. Our consolidated profit after tax for the quarter stood at 44 Crores and standalone profit stood at 66 Crores.

The profit after tax for the quarter is lower than the previous quarter as we had one time income tax refund accounted in the previous quarter. During the quarter, Government of India announced certain changes in the income tax for corporates. We are studying the changes and we are yet to take a final decision on our approach and hence our tax for the current quarter has been looked out on the rules as applicable prior to these changes.

The continued focus on improving efficiency of working capital during the quarter, we managed to bring our operating working capital by about 138 Crores during the quarter, which is over and above Rs.108 Crores that we achieved in Q1.

Our total project capital expenditure for the quarter was about 260 Crores. Our consolidated debt level moved up by about 203 Crores during the quarter and our debt as of end Q2 stood at 1843 Crores. Our debt to equity remained healthy at 0.64 on a consolidated basis and at 0.52 on a standalone basis.

Our planned capex for the year is still inline with the guidance that we gave during the last quarter. We expect our project capex to be in tune of 1100 Crores to 1200 Crores for the year on a standalone basis and there could be an additional about 102 Crores to 150 Crores for our specialty business. We had indicated capex estimate of about 200 Crores in the previous quarter, so there is a drop of about 50 Crores in our current forecast with respect to specialty business.

Now, let us open the floor for Q&A.

Moderator: Thank you. The first question is from the line of Jay Kale from Elara Capital. Please go ahead.

Jay Kale: Thanks for taking my question and congrats on a decent set of margins in the top environment. Sir, my first question was regarding your volume growth, if you just split your volume growth into replacement and OEM and then further into trucks and two-wheelers and passenger vehicles, replacement OEM to get a flavor and also exports because I see your exports has seen a sharp improvement in contribution at least?

Anant Goenka: With respect our growth, we have seen generally flattish growth in the replacement segment, we have seen of 15% kind and exports has seen single digit kind of growth. With respect to at a category level largely we had seen a challenging situation in the commercial vehicle segment OEM, while truck radial with our new plastics coming has seen substantial growth, truck bias from the other hand has seen quite a large negative growth and two-wheeler and SUV as we shared has been generally done well, as a replacement has done well, SUV has been doing well, good demand, we are seeing high growth in both exports and decent growth in OEM, but we have been short of capacity on the back of it, our plants had been slightly under utilized because of the some machinery issue, hopefully we are getting out of that and things will get better. We will also have Chennai plant coming in from next quarter onwards with that passenger car will get better. Scooter has seen good growth with the backing of last few years of strong growth. Scooter has been quite positive.

Jay Kale: Sir, any flavor on the market share on replacement as well as in the OEM segment you seem to have quite a few new orders for the new models on the passenger car side, any indication you could give say you what would be your passenger car OEM market share in one or two years earlier and now how it look right now?

Anant Goenka: We would have grown. We will can get back to you on the numbers, but clearly we would have grown and the higher growth, I think going forward in the next year because with our new capacity is coming in with a number of big orders that we have also got in the market we will now be starting to supply the scooter, so clearly we will be at 5% shift in market shares seen years' time approximately may be from something like 7% to 8% in the past to closer to 12%-13%.

Jay Kale: Sir, lastly just on your raw material side, how do you see that going forward and it has been just comment bit on the pricing side, how do you see that in the next couple of quarters?

Anant Goenka: I think, raw material is a little bit down the positive side, we expect about 1% to 2% reduction between H1 and H2 and on net realization that we expect to one was largely expected to remain flattish. I do not see any specific pricing action happening and I feel that generally things will remain between the value addition levels will not change too much.

Jay Kale: Got it, great, Sir. Thanks and all the best. I will come back in the queue for more questions.

Moderator: Thank you. The next question is from the line of Ashutosh Tiwari from Equirus Capital. Please go ahead.

Ashutosh Tiwari: Sir, how do you see the pricing involvement right now considering slow down and also RM basis are coming off?

Anant Goenka: The prices are generally quite stable at this point of time. We are not finding any pricing pressure, things are relatively stable. There are some schemes, discounts, etc., but not at a fundamental pricing level things are not really changing.

Ashutosh Tiwari: Secondly, on the RM side only, how is the RM cost, like say per kg basis from Q2 versus Q1 and going ahead, we already saw carbon black probably we will see the impact in the second, third and fourth quarters, how is the RW pricing basically trend over last year 2-3 months?

Kumar Subbiah: On a year-on-year, carbon black prices have gone up, quarter-on-quarter basis they have been quite stable actually with respect to Q1 to Q2. The raw material has come down by about a couple of percentage point both year-on-year and quarter-on-quarter.

Ashutosh Tiwari: Lastly on employee cost reduction, so is it like this is the rate at which it will sustain or you said leave encashment provisions were lower in the quarter, so that will increase, so how do you see the prices going ahead?

Anant Goenka: I think, there was small part of the employee was one time and some of it was sustainable, so we are seeing some improvement out there overall, I see about 50:50 kind of level.

Ashutosh Tiwari: Sir, can you define one off thing in that?

Anant Goenka: That we have bonus provisions we had made that were reversed.

Ashutosh Tiwari: That were reversed, what is the amount of that?

Anant Goenka: I would not have the exact number, but roughly about 50:50.

Ashutosh Tiwari: 50:50, versus the Q1 you are saying or the last year?

Anant Goenka: Out of all employee cost benefits, I say 50% is one time and 50% is the same.

Ashutosh Tiwari: Got it. Thank you.

Moderator: Thank you. The next question is from the line of Ronak Sarda from Systematix. Please go ahead.

Ronak Sarda: Sir, thanks for the opportunity. Sir, first the clarification of our CV sales now both in MCV and LCV, what would that PCR and TBR mix right now and as we ramp up of PCR capacity, how do you see that mix let us say one year down the line?

Anant Goenka: At the market level, the mix is about 50:50, for us bias sales, is still about 60% and radial is about 40%. Going forward, we expect this is to clearly to be 50:50 because we set up new capacities of radials and we have seen much higher radial growth internally and it will grow, so in a very short period of time, I think we will also move to 60:40 kind of mix maybe in 6 months or so.

Ronak Sarda: So, for H1 FY2020, it is 60:40?

Anant Goenka: Yes.

Ronak Sarda: Sir, the second question is on the PCR capacity as it comes up, would that be slightly margin dilutive because we are focusing more on OEMs versus the placement, how does this mix changed for us because we have played down in replacement till now?

Anant Goenka: No, on the truck radial side we have predominantly more replacement than exports.

Ronak Sarda: Sir, I meant for PCR capacity?

Anant Goenka: So, PVR capacity, we have good demand across our three categories, so I expect strong growth to come in both in exports, replacement, and we are quite short of capacity and OEM, of course we have new orders coming in. OEM market itself is down at this point of time to out of the existing market also, generally if you see the market is relatively down, we have got into some of the new sizes we have seen good growth. I would say that across the board, there should not be margin dilution overall because we are working towards increasing our work product mix within PCR also, so what we will be producing much more 16 inch, 17 inch kind of sizes and with that mix improving, margin should go up so net-net it will be at similar level.

Ronak Sarda: Sir, I mean you have highlighted the kind of raw material change on a year-on-year and Q-o-Q basis, so majority of the gross margin expansion has come because of the mix change or OE sales declining and replacement stabilizing and TBR increasing, so is it more of the product mix related improvement or this is purely fall in raw material pricing has improved, possibly we see this margin destruction?

Anant Goenka: No, I would say half of it has come from lower raw material prices and mix has also helped in some way, we saw more of passenger category and the better BU mix contributed to the balance.

Ronak Sarda: So, half of the expansion on a quarter-on-quarter basis is because of the mix and half is because of the raw material price?

Anant Goenka: Say, 60% raw material and 40% would be a better mix.

Ronak Sarda: Thanks and all the best.

Moderator: Thank you. The next question is from the line of Nishit Jalan from Axis Capital. Please go ahead.

Nishit Jalan: Sir, I have 2 questions, firstly in the balance sheet side, you have delivered quite a bit of improvement in the last 3 quarters, especially in the inventory side also we have seen good improvement, so just wanted to understand is this sustainable, there is more room to improve because the overall inventory days you have already gotten down to about half 40 or 45 days?

Anant Goenka: There is still some opportunity for us to optimize it for the current level of activity, we are looking everything in absolute value terms, so therefore, still some opportunity in terms of quality of inventory that we would be holding, so we would like to hold more fresh stocks and similarly on raw materials also, we are focusing more on quality of inventory, which means that do not hold more than certain specific period say 30 days and 45 days, etc. Small improvement is possible at the current level of activities and we could still get some additional efficiency in inventory in terms of absolute value.

Nishit Jalan: Sir, my second question is, if I look at your first half revenue mix which you share in terms of replacement OEM and exports and if I look at export used to be 12% of your revenues in first half last year and this has gone up to 15% this year, this indicates about 20% plus kind of revenue growth and similarly if I look at other segments, your replacement is flattish to marginally down on Y-o-Y basis, so just wanted to understand on the replacement side in India also have you seen similar kind of industry growth whether it is flattish to down and in exports what is that is driving such high exports, which product categories, which reason, if you can give some more clarity on that?

Anant Goenka: What is your exports growth number?

Nishit Jalan: I look at export is about 12% in first half FY2019 and it is 15% in first half FY2020, so if I look at the numbers, it is coming out to be about 22% to 23%?

Anant Goenka: Just to share with you, I think there is some mix up in the data. I think there is a change in data, earlier these to show the data in our standalone basis, now we are showing that on a consolidated basis, which includes our data of off-highway tyres, which primarily gets exported and therefore, there is a shift that you may be seeing at this point of time, but as I shared with you the overall export growth is about low single digit kind of growth, replacement as I said is flattish and OE is at about close to minus 15 kind of levels of growth.

Nishit Jalan: Fair enough. Sir, just wanted to understand in replacement have you seen some softness in demand in the last couple of months, are you seeing because especially July and August and September because especially on the truck side have seen any of such thing and on the PCR side, are you seeing growth on the replacement side now for the industry overall?

Anant Goenka: Yes, so on July and August particularly are anyways very weak months and we did see slow down general a couple of months, September got a little better overall from the market feel perspective, but the truck segment has primarily seen negative growth in the bias category, as I said radial has been growing well just because we have been underweighted on radial for a long time, but we have seen substantial growth on the radial side just as I said we have just been not having enough capacity for a long period of time, but bias is the one, which has shown substantial negative growth and OEM sector has been again shown much higher negative growth than the replacement sector.

Nishit Jalan: Thank you.

Moderator: Thank you. The next question is from the line of Siddhharth Mehra from Nomura Securities. Please go ahead.

Siddhharth Mehra: Thanks for the opportunity. Sir, if you can first highlight the ramp up on the TBR side, is it the run rate is on track or have we seen some change in the run rate, which we were doing and if you can also highlight what will be the utilization level across other plants like in two-wheelers and passenger cars?

Anant Goenka: Yes, on the truck radial side from the productionability side we are quite okay, we can produce more tyres, but with OEM slowdown that has happened on the truck radials, I will say that overall growth on truck radial side, has therefore got affected, which has reduced have overall utilization on the truck radial side, so we have not been able to sell everything of what we have been producing right now. On the overall capacity utilization, we are at about 70% capacity utilization from the plant rated capacity so for anyways you can rarely exceed at maybe 85% to 90% capacity utilization, so from the producible amount we would be about say 10% to 12% higher than that, so if you look at it from one perspective, it is at 70%, but otherwise from what we can sell I would be about 80% to 82%.

Siddhharth Mehra: Sir, segment wise if you can indicate what will be this number?

Anant Goenka: Segment wise capacity utilization?

Siddhharth Mehra: Yes.

Anant Goenka: Approximately, as a thumb rule I would say maybe about 78% lower than this average in the bias segments whereas we would be close to about 85% kind of utilization in the two-wheeler and close to 100% in the passenger car space, 100% of whatever we can produce we are selling. Say for example, can produce 1 lakh more tyres in passenger cars, we would have been able to sell that.

Siddhharth Mehra: Got it and Sir, will there be any changes to our capex plan of around 13 to 14 billion for this year, or it remains on track?

Kumar Subbiah: See in the last quarter we had revised our forecast to on a standalone basis 1100 Crores to 1200 Crores and we also gave an estimate of about 200 Crores for a specialty business, so standalone we are holding on to the same forecast of 1100 Crores to 1200 Crores for the quarter and may be the specialty could be in the range of 100 Crores to 150 Crores.

Siddhharth Mehra: Lastly Sir, if you can indicate what has been the industry replacement growth in the truck and bus radial bias segments and in the PV and two-wheeler in the first half or in the last quarter whatever data you have?

Anant Goenka: On the truck and bus segment, we would have seen about close to may be plus 10% growth overall in across all category. Replacement has been very high in the radial side whereas the OEM has been low and on the truck bias side we have seen quite a bit negative growth.

Siddhharth Mehra: Sir, 10% growth in across most categories in the replacement side?

Anant Goenka: Yes, this is for CEAT.

Siddhharth Mehra: This is for CEAT, okay. For the industry do you have?

Anant Goenka: No, I would not be having industry growth rates.

Siddhharth Mehra: Lastly Sir, on the tax rate, I understand you are still finalizing what to do, but generally if you can indicate if what tax rates will, any colour if you can give for say probably next year where can be our tax rates be that considering the changes which the government has done?

Anant Goenka: See we are still studying and evaluating. One of the implications on an account of the recent changes that MAT credit would not be available if you move to a lower rate of tax, so therefore we are trying to understand that impact, so may be once we make up our mind we would be able to share in terms of what are tax rates would be going forward.

Siddhharth Mehra: Got it. Thanks a lot.

Moderator: Thank you. The next question is from the line of Chirag Shah from Edelweiss. Please go ahead.

Chirag Shah: Thanks for the opportunity and congrats for the set of numbers. Sir, three questions, question one, is it possible to indicate your current submerge mix of what you have produced in Q2 and how different this is somewhere capacity side look at one with down the line? Sir, my first question is, can you indicate what is your Q2 production mix in terms of tonnage and how different it is from your one year down line capacity mix that what you have envisaged?

Anant Goenka: I can give you a broad mix of our tonnage today approximately volume category wise mix. We are doing about 32% is two-wheeler phase, about 15% in passenger car space, about 30% to 35% in truck and bus and then others in some other commercial vehicles like off highway tyres, small commercial vehicles, etc., would be the balance say about 15% to 18% or so. I think going forward there will be a clear increase more in the passenger car space and on the truck radial side. These are two new capacities that we have setup. While we setup new capacities, I think of my approximate guess is about 3% to 4% increase in the passenger care space going forward, so may be this 13% could go on to closer to 16% type of level and on the truck and bus side, while bias will show negative growth, the radial will show higher growth and difficult to predict what kind of mix change will happen. If you look at truck and bus as one segment, it may go up from 33% to 35% kind of number largely because you are going to show negative growth in one segment, but the big change will happen is if we will show higher growth that is the one clear change, so overall the two-wheeler and passenger segments, we will move from say today around 45% to closer to 50%.

Chirag Shah: Second question was on your raw material commentary and your gross profit per tonne, if I look at previous quarter, the last quarter, you have indicated a very stronger scenario of flattish Q-on-Q raw material basket scenario, despite that we have seen good amount of improvement in your gross profit per tonne sequentially, so how do we look at it, is that the fall in commodities have been envisaged at the beginning of the quarter hence we have benefited or it is purely because of mix?

Anant Goenka: It is more because of mix. OEM is one which is showing clearer, as you saw the data, replacement and exports had been kind of flat to positive growth whereas OEM has shown substantial negative growth, so a fair amount comes in that because between net realization and raw material excluding the mix it would not be a much change that is 50% to 60% is raw material and balance is mix.

Kumar Subbiah: See approximately as we earlier indicated our gross margin has improved by about 160 basis points, and say 60% of that could translate to raw material cost and balance is on an account product and category mix, so it is kind of equally distributed between the two.

Chirag Shah: Sir, last question was on the capex guidance as you have indicated of this amount that you are looking for this year as well as next year following FY2020 and even in FY2021 is there any part, which can postpone or this now the ballpark number that you will have to spend to respect of the demand cycle?

Anant Goenka: As of now this is the ballpark number that we will be spending, that is the plan.

Chirag Shah: But is there any scope of further reduction in this capex of this year as of 2021 also?

Kumar Subbiah: Current year unlikely. We have spend little more than half of it in the first 6 months of the year already and as Anant has indicated that Chennai plant is planning to commission in the next quarter we will incur additional capex to ensure that the plant is ready, etc., so we do not expect anything, the numbers to be different for the current year.

Chirag Shah: Just clarification on the off-highway our exports, so we are still is around, what is the current capacity that, is the capacity last one quarter right?

Anant Goenka: Sorry.

Chirag Shah: On the off-highway tyres, that is there in the subsidiary, has there been a capacity increase in last one quarter?

Anant Goenka: No, capacity has been the same.

Chirag Shah: Capacity is the same, utilization has it gone up?

Anant Goenka: Our utilization has also been flattish. There is no change in utilization. We have not seen growth and the seasonality is also weak and demand internationally also is very weak at this point of time.

Chirag Shah: Which geographies are you actually seeing a very strong response versus you initially envisaged and where we can expect the traction over there?

Anant Goenka: So, we are selling a larger number of passenger car tyres to EU so in that way we have seen substantial growth.

Chirag Shah: All the best and thank you very much.

Moderator: Thank you. The next question is from the line of Priya Ranjan from Antique Stock Broking. Please go ahead.

Priya Ranjan: Thanks for taking my question. One is on the volume growth side, so probably if may be I have missed that, you said probably 3% is volume decline quarter-on-quarter, what was the year-on-year do you have?

Anant Goenka: Year-on-year was minus 5%.

Priya Ranjan: First half, what was the overall volume growth?

Anant Goenka: It is close to similar levels, about 3% to 4% negative growth, but whatever there is a little bit better than the second quarter in terms of growth marginally.

Priya Ranjan: Just second question is on the OE side, when you see typically you have 60-40 ratio and 70-30 ratio in terms of first suppliers, second supplier, so in a downturn scenario, how do you see I mean, the ratio maintains or somewhere the ratio gets skewed in terms of the first supplier?

Anant Goenka: I think stable categories such as truck segment etc., Tier 3, Tier 4 supplier may get worse hit, but for example in categories like passenger car, etc., it very much depends on new launches, so today for example, we were in the Hyundai VENUE, etc., or the Triber, etc., now those categories are growing much faster and if you are there then you are going to by far beat the industry growth, but if you missed on the new product launches then your growth will get hit, whereas in the truck segment it is much more stable, so a lower preferred supplier will get cut in that environment.

Priya Ranjan: We know with that in two-wheeler we have very strong, so in case of passenger car, passenger UV side, are we mostly in top 2 or top 3 suppliers sort of course flat list?

Anant Goenka: Yes, I think, in passenger care segment wherein a strong position. We are in positive with respect to being a part of the new launches and therefore we have seen actually positive growth in the passenger car OEM space even in this weak environment whereas in the truck segment we are lower in the hierarchy where we have got possibly worst hit than our competitors.

Priya Ranjan: How do you see this specialty business, I mean the subsidiary business going ahead in terms of volume and profitability wise?

Anant Goenka: We feel that there is a good opportunity here in the longer term. At this point, the market is going through the tough time. I will say overall we are seeing negative growth at an industry level, see within India, if you look at off-highway tyre mining space, etc., lot of OEMs have cut capacity substantially, internationally also whether it is because of weather patterns that have been there, we have seen and drought also for example in certain parts of the US, it has been challenging in this last quarter. If you look at industry data or competitor data, it has been in the negative territory, so that is how it has been right now, but I say that overall the value segment as we call it is growing well, people are moving towards value segments and there are Indian players who have created a good brand equity for India, so we are quite positive about our opportunity for opportunity growth in off-highway tyre space.

Moderator: Thank you. The next question is from the line of Amin Pirani from Yes Securities. Please go ahead.

Amin Pirani: Thanks for the opportunity. My first question is on actually the truck growth, you mentioned that replacement growth is flattish to slightly positive, and while bias tyres actually overall leveraged completely to replacement, they have seen a decline, so are we seeing that on the replacement side, market is moving fastly towards radial or is just a temporary thing because if that is happening then as the market improves this could even strengthen further and bias could see even further sharper declines?

Anant Goenka: No, the data that I have shared is more attributive to us because we have substantial growth with new capacities in radial coming in, we are seeing higher sales in radial, so I am sure even in channel size say for example, if a dealer is selling 100 tyres, I just tell you at an extreme level 100 bias we see in the radial tyres, he may not be able to immediately sell the entire to make it 130, but he is going to say I am going to convert my customers and may be make it 70-30 or may be an 80-30 kind of mix, as we are growing there is going to be slightly higher negative growth in the bias segment, but overall version is going to happen and bias will continue to show negative growth in the longer term at least for the next couple of years, it may stabilize at may be 70% realization levels, 30% it should happen in the next three years time.

Amin Pirani: My next question was on the PCR side, I mean this capacity issue in the existing plant has been something, which you know has been constraining us for a long time if I am not mistaken, just I want to understand, is there a vendor issue with the machinery, I mean are there some breakdowns, are there some quality issues, what is happening there because we have been actually having to wait for this capacity to ramp up for quite some time now if I am not wrong?

Anant Goenka: Yes, so this is primarily because of, as we have grown, this is only to do with the passenger car side, now what has happened is that there is no problem with the production equipment, the challenge is primarily been warehousing and some amount of automation that we have to do, so with this number of SKUs, large number of tyres we have to manage the tyres to a high level of tyre handling automation equipment, this is something, which requires more skills in electronics, etc., and this is something where as complexity increases number of SKUs increase and it had become a little bit of bottleneck, so instead of increasing automation capability, working with vendors to make sure that the automation system that we have setup for tyre retrieval for aggregation of tyres that is where the challenge arises, so it has nothing to do with the core production equipment, but we do with automation. There has been an improvement because of some amount of debottlenecking, but I will say that we still have some way to go and I think it will take may be another 3-6 months to fully resolve.

Amin Pirani: Is there a risk that such issues could happen in the Chennai facility also or you think that there because it is a Greenfield things will be completely different just want to get a sense?

Anant Goenka: These problems come up generally when you reach full capacity or when we reach full capacity say 70%, 80% 90% capacity utilization that is when you start feeling pains. Not even in the first 20%, 30%, 40%, there is no problem because when you setup infrastructure there is enough space, enough material handling equipment, etc., that is there, which is unutilized because you would have setup for a full capacity, so to that extent Chennai will be say initially 20000 tyres per day capacity, so I would say for the first 10000, 12000, there should not be a problems, but by then our capability will improve, we will learn from this mistakes of these challenges we faced, so of course we will put in the capability in-house.

Amin Pirani: Thank you, and just one last housekeeping question, because of Ind-AS change obviously in depreciation now has certain cost, which were in other expenses if I am not wrong, so is it possible to quantify on a Y-o-Y basis, so I think EBITDA margin on a Y-o-Y basis is not necessarily comparable, so can we get the sense of how much depreciation would have increased on a Y-o-Y basis because of India's change?

Anant Goenka: I think we have broadly indicated the numbers in the last quarter and this quarter.

Amin Pirani: So, is it 10 Crores, I think you have mentioned like 10 Crores?

Anant Goenka: 10 Crores is the, see overall it has a marginally adverse effect on PBT, it is now about 5 Crores per annum, so PBT was understated to extent of 5 Crores because of the changes, but between the hedge the impact is approximately about 10 Crores.

Amin Pirani: Between 10 Crores, great. Thanks for the opportunity.

Moderator: Thank you. We will move on to the next question that is from the line of Jinesh Gandhi from Motilal Oswal Securities. Please go ahead.

Jinesh Gandhi: Sir, congrats on good set of numbers. First question pertains to TBR considering that our capacity is now up in running, can you indicate what utilization it is operating at currently?

Anant Goenka: So, I would say that I have this data for Halol plant, which is close to about 70% utilization levels, which includes, I talking about at a rated capacity, so in terms of actually producibility it would may be about 80% to 85% utilization levels today. At the TBR level we would be at about 80% in my view.

Jinesh Gandhi: 80% on retail?

Anant Goenka: Approximately, yes.

Jinesh Gandhi: And we are having capacity, how has been improvement in market share in TBR for us now?

Anant Goenka: So, again we do not have industry data in such short time, so short time means what happens is that industry data generally comes up about a month, 2 months lag, so we will be able to share that on the time, on the truck radials we would have gained market share by about at least a percentage and percentage-and-a-half between this time period because the market has been weak and we have seen about may be 20% plus growth in the replacement side.

Jinesh Gandhi: Understood, secondly with respect to our capex considering that we have been moderating our capex over the last 6 months for current year, any estimates, which you or any guidance, which you can give for FY2021 for our capex considering what we are spending now?

Anant Goenka: In our last quarter in engagement we indicated we expected to be the similar level as that of our current year, but we will keep reviewing it. We will get more clarity during the later part of the year depending on how we utilize our capacities.

Jinesh Gandhi: That 1100-1200 Crores for next year would be the balancing capex for PCR, two-wheeler and OTR, right?

Anant Goenka: Yes, it does not include OTR. It includes only the balance portion for PCR, two-wheeler and TBR.

Jinesh Gandhi: OTR would we need to invest something next year or this 100-150 Crores of this will be sufficient?

Anant Goenka: Currently what we are investing is not to increase the capacities. It is more to increase the range of product that we could produce. In terms of adding the traditional capacities, that specialty would depend on certain milestones that we need to reach with respect to utilization of existing capacities, so while the upstream can certainly handle, but for downstream closer to the pan you will take cost, long time items we have been little cautious in terms of ordering them in advance, so that as and when the additional capacity requirement comes up we are in a position to quickly produce.

Jinesh Gandhi: And in terms of time length for two-wheeler capacity and OTR as of now it is not certain in terms of, OTR will come, but two-wheeler is on track for early next year?

Anant Goenka: Two-wheeler capacity?

Jinesh Gandhi: Yes.

Kumar Subbiah: The two-wheeler capacity has already come on stream.

Anant Goenka: In the current quarter some portion of the two-wheeler capacity is available. We would be ready for commissioning subject to our requirement.

Kumar Subbiah: We are only right now working on expanding our range since our utilization levels are low at this point of time we need a complete range, which we are working on continuously increasing, so we add about 70-80 products at least every year, so to that extent there will be some investments in securing tyre building machines to increase, have a range and once utilization levels go up we will then look at further adding capacity at that time.

Jinesh Gandhi: And OTR is operating about 80% of utilization?

Anant Goenka: Our OTR radial is at about 40% kind of capacity utilization today whereas the balance also right now is down actually just because of OEM slow down, but overall bias has been at 100% till last year because that will always limited capacity, I say we need at about 75% today or so roughly.

Moderator: Thank you. We will move on to the next question that is from the line of Nishant Vass from ICICI Securities. Please go ahead.

Nishant Vass: Sir, thank you and congratulations for a good set of result. Sir, first question was on free cash flow structure and how you guys think about it going into next year, considering that obviously there has been some improvement in profitability, will it be a long to assume that you will start return free cash flow negative next year?

Kumar Subbiah: Free cash flow would be negative after you adjust for capital expenditure related cash flow. In the next 2 years, it will be like that, we are only trying to reduce the gap between amount of borrowings that we do versus the total capital expenditure, so trying to maximize our internal accruals, but we would be free cash flow negative for the next 2 years.

Nishant Vass: Basically both this year and next year?

Anant Goenka: Yes, correct this year and next year.

Nishant Vass: The second question is for Anant, as a senior industry participant, how do the industry and you guys look at the RCEP that the government is looking at and what are your worries and concerns on this, if any?

Anant Goenka: We respect to RCEP, I think here we need to, what has happened is that there has been clearly the Chinese tyres that were coming into the industry had been stopped because of the injury that they were doing to the industry with antidumping duty is coming in. There has been an increase in terms of tyres coming in from Thailand and what is concerning to us is that some of these tyres are coming in at again price, which is uncompetitive possibly because of some benefits, which is closer again to relatively lower cost may be about 20% lower than us, these are largely Chinese tyres as well, so we need to just understand, do some research, if there is unfair competition we will be working with the government in certain categories where we feel it is fair, let tyre imports happen, but if it is happening at a price, which is fair I think that is okay with us, so we are analyzing data from Thailand and then we will work with the government to see if there is any duties that we want to support them.

Nishant Vass: To clarify, I would be getting that if we go and sign the RCP, we can also continue to look at these other measures post RCP signing and provide some safeguards?

Anant Goenka: No, I think we will be lobbying to the government and sharing with them data what is happening, now if RCP is going to reduce duties completely, we will have to further understand because what is happening is the duty of 25% to 30% on rubber coming in and if there is zero duty on tyres that make it extremely un-competitive, I know government will accept that position that is there, in terms of below duty on tyres, but 13% duty on rubber, so on that case we will have to work with the government and I am sure I will be very surprised if they will remove duty on tyres completely, so we have to just work on that to understand; however, so that is based on today's clarity, but what I am saying is there has been a substantial increase in imports from Thailand that have been coming in. We need to look at based in data what the prices that we are coming in, if there unfair injury happening, then we will lobbying to the government, if it is not unfair, if the tyres are coming at a price, which is fair based on raw material price plus conversion cost and other cost that are there then I think we do not have a case to the government, so we just analyzing the data and we will come to the government at the right time, if we feel there is unfair prices.

Nishant Vass: Thank you. I will get back in queue.

Moderator: Thank you. We will move on to the next question that is from the line of Bharat Gianani from BNP Sharekhan. Please go ahead.

Bharat Gianani: Sir, thank you for the opportunity. I just wanted to know that you indicated in the call that the replacement demand is pretty weak and it was about flattish for this quarter on a Y-o-Y basis if you compare, so what is your understanding on the replacement market, how long it will remain weak and what is your reading actually, how much time it will take for the market to recover, so just some comments would be helpful on that, thanks?

Anant Goenka: Very tough to say when the markets will get better, no way of predicting that I will. Frankly those things are still weak despite Diwali being just round the corner. My broad guess is that the market will remain at a similar kind of level for the next few months at least, hopefully, early next year things will start getting better, but I do not think we are in a position to give any forecast for the market at this point of time, we can only say what is happening right now.

Bharat Gianani: Fair enough, thanks and all the best.

Moderator: Thank you. The next question is from the line of Ashutosh Tiwari from Equirus Capital. Please go ahead.

Ashutosh Tiwari: Sir, firstly on the balance sheet side, there is a 100 Crores increase in other financial liabilities that we removed the current maturity of debt this is mainly because of the increase in capital vendor payables?

Anant Goenka: You are talking about normal debt increase?

Ashutosh Tiwari: No, I am talking increase in current financial liabilities which has increased from 580 Crores to 638 Crores, but if I remove the current maturity long-term debt, there is almost an increase of 100 Crores from March levels?

Anant Goenka: So, this has a capital liability on projects.

Ashutosh Tiwari: Can you quantify that number, I think it was 185 Crores as of March 2019 can you quantify the current number?

Anant Goenka: 281 Crores.

Ashutosh Tiwari: Secondly, if I look at the consolidate minus standalone EBITDA, the EBITDA that is probably only the specialty tyre tyre business, EBITDA, that will become negative in the current quarter versus a bit positive in Q1, so if there is any profitability deterioration happen in the specialty tyre with this?

Anant Goenka: Can you repeat question?

Ashutosh Tiwari: If I look the subsidiary EBITDA, if I just reduce the consolidated minus standalone, then the EBITDA for specialty tyre business had deteriorated on a quarter-on-quarter basis to negative, so is there any further profitability pressures in that?

Anant Goenka: No, the EBITDA for the specialty business for Q2 was lower than the previous quarter and also on an account of lower level of operations, the sales volume was a little lower than the Q1, so our plan earlier was to stay at EBITDA breakeven at some point in time, we were negative in Q2 on specialty business.

Ashutosh Tiwari: So, I just seeing in the market also, what is the necessity to do this capex may obviously we would have slashed the capex from 200 Crores to 150 Crores, but is there any need to do that capex in the current year?

Anant Goenka: It is not to add capacities, it is only to produce because the key task for us just to improve the capacity utilization of the plant and that will happen only if we have capability to produce more range, so we are not adding capacities, we are only creating capabilities to produce more and our EBITDA was positive in Q1 for specialty, marginally lower because of slight drop in volumes in Q2 versus Q1, so as we increase our capacity utilization, okay we then moves into positive zone, in fact gross margin for specialty business is higher than our CEAT standalone by a reasonably higher levels, so therefore capacity utilization is an important lever for us to get more margins out of specialty business and therefore, we are investing on that capabilities.

Ashutosh Tiwari: Lastly on this only, so is the only export that you do from that subsidiary?

Anant Goenka: Yes, from the subsidiary we are doing only exports.

Ashutosh Tiwari: Thank you.

Moderator: Thank you. The next question is from the line of Anand Bhavnani from Unify Capital. Please go ahead.

Anand Bhavnani: I have two questions, one is the gross margin improvement that we have seen in this quarter it is due to primarily raw materials have fallen, so my question is, do you expect further improvement here on, is the entire fall reflected or do we see prices to correct more and margins to improve further for us?

Kumar Subbiah: No, earlier Anant has indicated second half would be lower than first half by in the range of 1% to 2%, and mix plays a role in terms of overall gross margins, but in generally the positive thing is that raw material prices have softened recently, but the impact is to extent 1% to 2% in second half versus first half and if the category mix does not change, it could flow into gross margin, but it depends on the category and BU mix.

Anand Bhavnani: Secondly, I see there is a sharp year-on-year fall in employee cost and also quarter-on-quarter fall, so if you elaborate the reason for it?

Kumar Subbiah: I think, Anant has elaborated a little earlier, largely on an account of two reasons, one is that leave encashment provision was lower in Q2, depends on our actuarial valuation and the second is also the outgo in terms of performance bonus was lower and that also is reflected in Q2.

Anand Bhavnani: But then what we should we take it as normal run rate, so normal run rate would be around this 125 Crores kind of figure or would it be like that?

Kumar Subbiah: It will go back to Q1 levels.

Anand Bhavnani: 134 Crores?

Kumar Subbiah: That will be some minor inflation as we commission our factories, the employee cost will also increase, so that is what I think Anant has indicated that the distribution of these two, so go back to Q1, okay I assume a small inflation for on an account of annual salary corrections and any additional workforce that we would be engaging in new locations would also have some impact on employee cost.

Anand Bhavnani: Sure Sir, and last one question, of the various segment that we operate in TBR, OTR, two-wheeler, PCR, which ones are you seeing improving quickest and where do you see outlook as worst?

Anant Goenka: I think the highest growth is expected to be in the passenger car segment followed by the truck radial segment in terms of where we would see relatively lower growth possibly at this point of time truck bias is one where we expect to be a negative territory because that as a segment technologically seeing a long-term structural shift.

Anand Bhavnani: But, for example, we have two-wheeler capacity, which is available, so there how do you see the situation?

Anant Goenka: Two-wheeler, I think we expect to see normal growth. I think motorcycle segment is normal growth means growth at the pace of kind of GDP, market kind of growth in the shorter term at this point, because generally sentiment is weak, we have about 30% market share, and so I would say we expect to see normal growth in the two-wheeler space.

Anand Bhavnani: This would replacement or OE or any particular?

Anant Goenka: On average is what I am sharing with you, weak sentiment that could move to negative because OE is at negative growth, but if that picks up it will be positive, so just kind of stay at market growth level.

Anand Bhavnani: So, broadly we are expecting market share gains in replacement in two-wheelers, if I were to infer?

Anant Goenka: Peak has reached in passenger car and truck radial.

Anand Bhavnani: But, if OE two-wheeler does not grow and there we will grow at market growth rate then we will grow through market share gains and aftermarket as well right?

Anant Goenka: No, not aftermarket, I am saying that on two-wheeler, we will approximately remain at market level.

Anand Bhavnani: Thank you.

Moderator: Thank you. Ladies and gentleman, due to time constraint, that was the last question. I now hand the conference over to the management for their closing comments.

Anant Goenka: Thank you very much for your interest in CEAT. We look forward to staying in touch. Please feel free to stay in touch with us if you have any other questions in the meantime and look forward to catching up again next quarter. Thank you.

Moderator: Thank you. Ladies and gentleman, on behalf of Batlivala & Karani Securities, that concludes this conference. Thank you for joining us. You may now disconnect your lines.