"Shaily Engineering Plastics Limited Q2 & H1 FY-19 Earnings Conference Call"

November 15, 2018

MANAGEMENT: MR. SANJAY SHAH – CHIEF STRATEGY OFFICER, SHAILY ENGINEERING PLASTICS LIMITED

Moderator: Ladies and gentlemen, good day and welcome to the Shaily Engineering Plastics Limited Q2 & H1 FY19 Earnings Conference Call.

This conference call may contain forward-looking statements about the company which are based on the believes, opinions and expectations of the company as on date of this call. These statements are not the guarantees of future performance and involves risks and uncertainties that are difficult to predict.

As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Sanjay Shah. Thank you and over to you, sir.

Sanjay Shah: Good afternoon and a warm welcome to all the participants to the post results earnings call of Shaily Engineering Plastics Limited. I hope you have had a look at our investor presentation that is uploaded on our website and the stock exchange.

H1 was a soft period for us in terms of revenue growth. We firmly believe that growth rate could have been higher however we were faced with labor & other issues which we talked about in the last call. With no longer carrying themselves in H2 we expect better H2 performance.

What is heartening is the clients faith in our abilities resulting in continued momentum on order wins.

In Q2FY19, we got Business confirmation from a large global department store for a product in the home segment. We expect to commercialize the same by the end of Q3FY19. This a prestigious order and has potential of incremental business going forward.

We further got Business confirmation for manufacture and supply of 2 new products from our largest customer in the Home Furnishings major.

Given the varied capabilities that we have built across verticals and solution based approach with customers to offer them a complete product is enabling us to increase our share of business with marquee customers.

I shall now go to the operation and financial performance in Q2 FY19. During the quarter we processed 3,431 tons of polymers as against 3,374 tons of polymers in the same quarter last year. For H1 we processed 6,978 tons of polymers as against 6,016 tons of polymers in the same period last year, increasing by 16% Year-on-Year.

Machine utilization rate stood at 68.8% during Q2 FY19 while for H1 FY19 the same was around 70%. Exports during Q2 FY19 stood at 68% of the total revenue while for H1 exports contributed 72%.

For Q2 FY19 our revenue stood at Rs. 86.4 crores showing a Year-on-Year growth of 10% from Rs. 78.8 crores in the same quarter last year. For H1 FY19 our revenue stood at Rs. 175 crores a growth of 18% Year-on-Year basis. If you recollect that our Q1 revenue growth was soft on account of labor issues.

EBITDA margin for Q2 FY19 is Rs. 15.5 crores versus Rs. 14.9 crores in Q2 FY18 growing by 4% Year-on-Year. EBITDA margin stood at 17.9% in Q2 FY19 and H1 EBITDA stood at about Rs. 29.5 crores a growth of 9% on a Year-on-Year basis with a margin 16.8%.

The stability in FX and pass through mechanisms in most of contracts with customers we expect margins to stabilize going forward. Finance cost has increased both from Q1 and H1 on a Year-on-Year basis on account of increased debt taken for land purchase and CAPEX for expansion which we have talked about in the past. With faster sales growth we expect leverage to kick in.

Net profit for Q2 FY19 is at Rs. 5.8 crores down 10% on a Year-on-Year basis with a margin of 6.7% while for H1 the profit stood at Rs. 11.5 crores, a growth of 6% on a Year-on-Year basis with a margin of 6.6%. Higher provision for taxes compared to last year impacted our profitability.

Cash PAT for Q2 FY19 is at Rs. 9.2 crores as against Rs. 9.8 crores in Q2 FY18. While for H1 FY19 we have witnessed a growth of 3% and cash PAT from Rs. 18.1 crores to Rs. 18.7 crores in H1FY19. Our CAPEX spent for Q1 FY19 was Rs. 17 crores which was primarily towards acquisition of land.

This is all from our side. Now we can open the floor for Q&A. Thank you.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question-and-answer session.

The first question is from the line of Manish Gupta from Solidarity Advisors. Please go ahead.

Manish Gupta: Can you talk a little bit about longer term growth outlook if we take a rolling five-year view from here where you are seeing growth? Can you talk a little bit about the risks you see given lot of talk about trade barriers and protectionism how you see some of these impacting your business?

Sanjay Shah: So, Manish, if you look at growth, I think probably last two quarters have been little muted in terms of growth but we are pretty aggressive about growth and we are seeing that in the orders which are being closed by our team and everything. So, we are quite aggressive about growth.

And I think we first like to reach to the 2020 target or close to the 2020 target which we have talked about before we give more of a five-year vision.

But even if you were to look at five year basically, we are looking at average of about the growth rates which we have achieved and which we have targeted in the past for the next five years. In terms of risks you want to talk about trade barriers and protectionism and everything what I am seeing this is actually an advantage to companies in India with the type of trade wars which are happening between the two largest economies in the world people are looking at moving out or at least de-risking themselves and getting in to different geographies or different countries where there exists a huge potential for companies in India to take advantage of that. And we are seeing a potential for that.

Manish Gupta: Can you talk a little bit also about how you see your margin trajectory going forward, what are the factors and clearly I guess pharma is far higher margin category for you but again as you think about your business in long term can we expect to see some operating leverage also play out? So, again if we take a slightly longer term view where do you think margins at an EBITDA level will be say a couple of years out and what are the drivers that will lead to an increase in margins?

Sanjay Shah: There will be two things. One is operating leverage will settle in terms of as we improve efficiencies and everything. If we were to look at last two quarters our plant utilization levels have also been lower so to that extent the benefit of operating leverage haes not kicked in in the current quarter and we should basically be able to take that advantage. As you rightly said as we move up on the pharma chain business there is lot of commercialization is going to happen in next year.

You should basically be able to see margins improvement coming from there also. So, even lot of new products and new businesses which we are adding in other segments we are looking at better margins from that. So, this also should help in terms of getting to better margins.

Manish Gupta: But do you have a range longer term how much you think margins could be higher from here?

Sanjay Shah: Manish, we do not want to put in a number but I would say if we were to look at last two quarters our margins have been also little muted. We should basically get back to our normalized margin and from there we should basically be looking at improvement.

Manish Gupta: What are some of the risks you see? What can go wrong in your story?

Sanjay Shah: Risks will be some of it would be execution risks in terms of projects getting delayed either from Shaily's end or from the customer end or something. This is probably one of the single largest risk that you would see.

Manish Gupta: Okay and on that. $ 100 million target that you have for FY20 what is the visibility you have on that as of today?

Sanjay Shah: I would still say still between 80%, 85% visibility which we have.

Moderator: Thank you. The next question is from the line of Shailee Parekh from Prabhudas Lilladher. Please go ahead.

Shailee Parekh: Sanjay Bhai, my question was pertaining one of course I wanted to understand if there is any seasonality across the four quarters since we operate in various segments, is there a seasonality factor at all in that place out through the quarters? My other question was about the power and labor issues that you mentioned right at the start of the call. How are we placed with those, I mean have we been able to come back those challenges or are we likely to continue to face those headwinds in Q3 as well?

Sanjay Shah: So, the power problem has been fixed and the labor issues have also been fixed. The power problem got fixed probably by end of October just prior to Diwali.. The labor issues have also been fixed. So, those are two issues which have been fixed and you should start seeing the benefits of that by Q4. I am sorry I lost you on the first part of your question?

Sanjay Shah: About the seasonality question, it is typically on exports you typically have a Q2 which is a little slower quarter because most of your shipments for Thanks Giving or Christmas gets pushed in by mid of October. Then you also have projects which are being executed and everything which was there last year. So, which basically help us in terms of getting a better Q3.

Shailee Parekh: So, Q2 is historically seasonally a weak quarter of your four quarters?

Sanjay Shah: Q3 is the slower quarter in terms of exports. .

Shailee Parekh: My last question would be pertaining to what even the previous person asked you about the vision statement that you all have made in terms of wanting to achieve the $100 million topline by next year. If I was to just go by the past trends and if I have to just break H1 and H2 and extrapolate that ratio to this year as well.

I mean rough back of the hand calculation tells me that you should be ending this year somewhere between may be Rs. 370 crores to Rs. 390 crores in terms of topline and if you have to still continue and achieve the target that you have set for yourself and I will be very happy if you did achieve that target.

We are looking at a very aggressive growth rate in FY20 which could be actually upwards of 60%, 65% I mean and to that you have said I am just going to repeat this that you have an 80%, 85% visibility to achieving that kind of an aggressive growth number in FY20?

Sanjay Shah: Yes.

Moderator: Thank you. The next question is from the line of Akhil Parekh from Elara Capital. Please go ahead.

Akhil Parekh: Sir, my question is on the home furnishing side. This new project of carbon steel when are we expecting it to start the commercial sales?

Sanjay Shah: We are looking at commercial sales from Q3 of FY20.

Akhil Parekh: And we are on track on the plant and all those things?

Sanjay Shah: We are on track, so this is just to give an update to all of you. We would be starting construction, the land is now being transferred and we have got the necessary approvals in terms of conversion of land. We would be starting construction sometimes in December and also, we are placing major orders in December.

Akhil Parekh: And just to confirm this Rs. 100 crores sales is an annual turnover, right that we can expect?

Sanjay Shah: Yes, on the carbon steel, yes you are right.

Akhil Parekh: And the second question is on the margin side. Obviously, there is some pressure on the margin. For first half almost 150 bps of decline is there. How much of this decline is because of the change in product mix and how much is because of the increase in raw material prices?

Sanjay Shah: I would say majority of it is basically on account of the change in raw material prices and some of the margin issues are basically in on account of the power and labor issues which we had which we are trying to correct it.

Akhil Parekh: So, just to clarify for the raw material side you are saying is it because of the change in the raw material or increase in the raw material prices?

Sanjay Shah: No, the increase in raw material prices. Akhil, what happens is there is a lag when prices get corrected with customers. So, if you were to look at last two or three quarters you had either crude moving up which basically would have translated in to raw material prices moving up or FX moving up which would also translated into the raw material prices moving up. So, there was always a lag effect which was there which hopefully is getting corrected in Q3.

Akhil Parekh: Okay so we expect second half to be better given that the crude prices are on decline right now?

Sanjay Shah: Yes.

Akhil Parekh: Sir, one more query. The new product from the new home department client would you be able to clarify what product is there and what will be the quantum of the order size?

Sanjay Shah: The order is about Rs. 10 crores to Rs. 12 crores. And it is from a large supermarket chain in the Europe.

Akhil Parekh: And what exactly is this product?

Sanjay Shah: It is a product for use at homes is what I can say. Once we start shipping this probably, we would put a photograph of that product in the presentation also.

Akhil Parekh: And the commercial sales for this which is expected to be the second half or the first half?

Sanjay Shah: It should start by end of Q3 FY19.

Akhil Parekh: Okay so this quarter itself?

Sanjay Shah: Yes, this quarter.

Akhil Parekh: And sir, last question is on CRC. Any further traction as compared to what we did last quarter?

Sanjay Shah: We are seeing much better traction as compared to what we were I would say last quarter and the quarter before that. So, we are right now shipping about 5 lakhs to 6 lakhs of CRC caps a month to customers and we are seeing traction with other customers also. That should start showing much improved trends going forward.

Akhil Parekh: Sorry 5 lakhs to 6 lakhs caps plus bottle or just the caps?

Sanjay Shah: Just the caps.

Akhil Parekh: So, that roughly should convert in to Rs. 18 lakhs something right per month?

Sanjay Shah: I leave the number crunching to you.

Moderator: Thank you. The next question is from the line of Nikhil Kothari from Tamohara Investments. Please go ahead.

Nikhil Kothari: Sir, I wanted to ask any update on CRC?

Sanjay Shah: I just talked about this when Akhil asked this question. We have started some regular shipments to our customer in the US and we are seeing some traction with some of the customers also and we are developing couple of new sizes. We are seeing lot of traction and some sales also on a consistent basis going for the last three months from the last quarter.

Nikhil Kothari: And sir, one more thing. Since this quarter the growth was subdued so you have all the orders and there would be some delivery schedule from home furnishing major or other clients. So, that is not affected because you could not supply at this quarter or so I mean is there any problem with them then?

Sanjay Shah: No, obviously there is a problem in terms of lost orders. So, to that extent there is an issue but that we should be able to build it up going forward, this is what we would say and that is one of the reasons why customers are still having faith in us and have given two large orders to us.

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

Ankit Gor: My first question is with reference to the revenue which we would have lost because of labor and power issues in the first half. If you can quantify that, that will be great for me?

Sanjay Shah: It is pretty high.

Ankit Gor: And with regards to these hedges the INR was obviously we being exporter of the product. How INR has impacted our revenue? Have you seen some INR benefits in our overall revenue or not?

Sanjay Shah: Ankit, if you remember most of our exports to our home furnishing customer is in rupees. So, if dollar moves up or dollar moves down it does not help us effectively to that extent. Balance exports basically would cover the import part of it, our imports will be higher than that. So, to that extent it is a negative impact to our customers.

Ankit Gor: Just connecting that point. When we say your EBITDA margin impacted by higher raw material prices but gross margin remains where it was even in Year-on-Year or Quarter-On-Quarter. So, gross margin did not get affected much so what is the basic rationale behind little lower not lower EBITDA margin there?

Sanjay Shah: Well, as I said earlier our margin got hit on two accounts. One is on account import prices going up and second is we are having higher cost because of lower utilization levels because of the power issues and the labor issues which were there.

Ankit Gor: Again connecting the issue there when you said that those issues got resolved now and for this you must have incurred some extra cost. Do you believe that in Quarter-on-Quarter our margin will impact because of these whatever extra costs we must have incurred?

Sanjay Shah: What we have incurred was basically we got a dedicated line from the power company. That was more of a CAPEX. Operationally the cost would be in terms of manpower, higher power cost and higher overheads.

Ankit Gor: Okay so that will come in 2H it means?

Sanjay Shah: No, that has already taken into account because expenses were accounted on an accrual basis so all of the expenses have come. Even if you were to look at the numbers and if you were to look at manpower cost and vis-à-vis compare it to historical last year you will see a higher manpower cost in Q1 and Q2 and higher power cost in Q1 and Q2.

Ankit Gor: And my question probably last one with regards to working capital. It has stretched a little bit. So, what do you believe on a full year basis how it can look like because debtor days has also increased?

Sanjay Shah: So, debtor days have actually come down. If you were to look at from a March number debtor days have actually come down. So, working capital in fact has seen an improvement from March to now. So, if you were to look at March my debtor days were about 68 days, in September my debtor days are at about 66 days. So, it is down by 2 days. In terms of debtors over 180 days there has been a substantial improvement where we were at about Rs. 3.6 crores as of March it is at about Rs. 1.2 crores right now.

So, that has come down substantially. Similarly, if you were to look at other current assets and everything they have also come down. So, we have been able to get refunds from GST, and some of the fixed assets that have come down. Even if you were to look at working capital they have broadly come down as compared to March. The reason why you see an increase in borrowing is basically we have increased the term borrowings by 30 crores, because we took the debt funding which we have talked about in the last call.

And this is what is there otherwise I do not see debt or working capital issues at all. Even if you were to look at total debt to equity in March it was around 0.86 and right now it is 0.88. And this includes working capital debt.

Moderator: Thank you. The next question is from the line of Amruta Deherkar from Trivikram Consultancy. Please go ahead.

Amruta Deherkar: My first question is in to the line of I missed out your comments on the employee cost. In the previous quarter the run rate was roughly around Rs. 8 crores so now in the first and second quarter it is roughly touching Rs. 10 crores. So, is this increase in employee cost like the new run rate or is it pertaining to the power and the labor issues which was there and trying to get it back to normal?

Sanjay Shah: I did not get the numbers like Rs. 8 crores and Rs. 9 crores because if I were to look at my employee cost in Q1 it was about Rs. 9.9 crores and in Q2 it is about Rs. 9 crores. In fact, it has come down..

Amruta Deherkar: Actually, I am comparing to the previous year the first quarter and second quarter of the previous year and comparing it to the first and second quarter of FY19. So, there the increase is like that is going to be the new run rate or is the labor issues having contribution to that increase?

Sanjay Shah: So, probably we will need to look at more from a Q1 to a Q2 perspective wherein Q1 we had said there were labor issues and we had a higher labor cost which we are going to bring it down. There is scope to bring it down which we are working on getting this done. At the same time, we have been looking at normal increases which would have been driven which gets reflected in the higher wage bill.

Second is we have talked about it I think probably not in the last call, the call before that. We are increasing bandwidth within the organization to basically help us move the organization to the next level in terms of managing projects, managing multiple plants and everything. So, we are adding people at various levels like at senior levels. You will see those costs increases also and the higher manpower cost.

Amruta Deherkar: My second question was about getting the dedicated power line will that result in some cost benefits and like if you could quantify what kind of benefits we could receive?

Sanjay Shah: In terms of a unit cost basis there is no unit advantage to it. It does not give you an advantage on that. The only advantage is the stoppages which were there, the breakdown which were there in terms of disruptions which were there because of power going off. They were to be much less. So, to that extent it will benefit in terms of lower down time, better utilization, better plant productivity.

Moderator: Thank you. The next question is from the line of Abhilasha Satale from Dalal & Broacha. Please go ahead.

Abhilasha Satale: I want to ask that now that the raw material increases and all you must be able to pass on with the lag effect. And also labor and power issues getting sorted. Do we have a visibility that in H2 the margins will improve on Quarter-on-Quarter basis like will it be in the range of 18%, 19% what we have achieved in the past?

Sanjay Shah: Abhilasha, I do not want to put in percentages but we are obviously looking forward to an improvement in margin but I do not want to put a number.

Abhilasha Satale: So, on a Quarter-on-Quarter basis we might see some margin improvement?

Sanjay Shah: I am very clearly saying I do not want to put a number there but Yes, we do expect margins to improve. This is what I would say.

Abhilasha Satale: Secondly, on CAPEX part I want to understand like how the CAPEX is structured over next two years towards carbon steel facility and other expansions what we are doing?

Sanjay Shah: We talked about that in detail on our last con call. We expect the carbon steel CAPEX to be at about Rs. 40 crores. We are investing about Rs. 25 crores to Rs. 30 crores in growing our plastics business, in the the current year and similar amount in the next year also.

So, it is Rs. 30 crores and Rs. 30 crores and Rs. 40 crores that is about Rs. 100 crores and we will invest about Rs. 15 crores to Rs. 20 crores per year for tooling. So, put together between this year and next year we should basically be looking at somewhere around Rs. 120 crores to Rs. 130 crores of CAPEX based on the current business which we have had confirmations for or what is expected.

Abhilasha Satale: And this carbon steel CAPEX of Rs. 40 crores by when would we incur this?

Sanjay Shah: We will start incurring that from next month and we should basically be looking at commercializing that facility by Q3 of FY20.

Moderator: Thank you. The next question is from the line of Manish Gupta from Solidarity Advisors. Please go ahead.

Manish Gupta: So, Sanjay, just wanted to check the lost sales because of your power situation and labor situation is the sales that you have lost or is the sales that get carried on pushed back to Q3 and Q4?

Sanjay Shah: Manish, those are sales we have lost because you will not be able to push our sales back.

Manish Gupta: So, your business is a relationship-based business so if a customer is giving certain orders to you but you lose those sales because of a situation at your end then that order would go to some other vendor in the system, right?

Sanjay Shah: On a temporary basis, yes.

Manish Gupta: So, just the fact that you have a labor situation, or you had a power situation does this affect the strategic dynamic or relationship between you and your customers because one of the reasons why with the home major I guess you got the steel furniture order was because of the steady supply chain reliability?

Sanjay Shah: So, we have been in discussions with this customer in terms of telling them what the issues have been and what the steps have been taken to basically resolve that and we have also given them assurance that the situations will be normal soon. So, that is a constant dialogue with our plant teams has had with our customer and we also what we are having with our customer on a very regular basis.

Manish Gupta: The other follow up question I had Sanjay, was I guess since you are maintaining your target for fiscal year 20 it would suggest massive ramp in growth rates from here. And given the fact that we have had a labor situation and given the fact that this is manufacturing we are also launching multiple new products. How is the organization gearing itself for that large kind of quantum of growth you are looking for, and it is not accompanied by quality issues?

Sanjay Shah: We have been investing in people at various levels because as we grow and if we are growing at 25% to 30% over an excess we obviously need to build up the organization because if we do not built up the organization you will not be able to grow. We have been investing in people and that is one reason I think one of the participants in the call asking this question that we had higher manpower cost and I said very clearly that some of the higher manpower costs has been because we have been adding people at various levels whether it is in plant and technical services and quality and demand in various places to basically get to that level of growth.

Manish Gupta: And like we did a related diversification in to steel furniture are there other areas we are planning to extent our competencies into?

Sanjay Shah: As of now there is nothing on the table.

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

Umang Shah: Sanjay Bhai, if you could just jog my memory. What was this labor issue related to? Somehow, I missed I mean I cannot recollect that as of now?

Sanjay Shah: So, we had labor issues where people were not coming in or we are seeing absentisim in everything so which is basically been able to tackle that and further fix it.

Umang Shah: So, the primary reason for that would be for the strike or something?

Sanjay Shah: No, we do not have a strike.That is the perception in fact there was no strike or lockout or anything. Our working were on.

Umang Shah: Okay the primary reason why I am asking this is because as far as our major client is considered they are particular about taking care of the social environment or the workers' environment that their suppliers deal with. So, is there any case that they have approached us or the audit which they do regularly on regular basis has come up any doubts on that if you could give some light on that?

Sanjay Shah: No, not at all. In fact, we just went through an audit recently and we still continue to be one of the top suppliers in terms of social environment and the compliance issues.

Umang Shah: So, there is no hiccup even when they know about the situation?

Sanjay Shah: There is no issue on that. In fact, we recently getting through an SA8000 audit also which was mainly to deal with environment health and social responsibility and we have also been recommended for SA8000 certification. You just preempted in terms of telling that I would have basically show that in from the next quarter.

Moderator: Thank you. The next question is from the line of Rishabh Vasa from Almondz Global Securities. Please go ahead.

Rishabh Vasa: My first question is that in the last three quarters basically we have done net sales in the range of Rs. 85 crores to Rs. 90 crores basically. So, by when do we expect to cross the Rs. 100 crores mark on a quarterly basis and what would be the key drivers for it?

Sanjay Shah: I think you should see that from Q4 onwards is what I would say. Drivers would basically be orders which we have had from various customers whether it is the home furnishings major or other customers across automotive, FMCG appliances various segments which we spoke.

Rishabh Vasa: I just wanted to know the capacity utilization rates for the CRC caps and the injection molding business basically?

Sanjay Shah: Rishabh, we do not report individual capacity utilization. What we have reported is an overall machine utilization rate of about 71%.

Moderator: Thank you. The next question is from the line of Shailee Parekh from Prabhudas Lilladher. Please go ahead.

Shailee Parekh: Sanjay Bhai, two very quick questions. One was that your asset turns have typically been in the range of 2.5x. Is that a similar rate that we can assume for the new capacity the Rs. 40 crores project that we are setting up as well?

Sanjay Shah: So, on the Rs. 40 crores carbon steel we have said very clearly we are basically looking at revenues of about somewhere between Rs. 100 crores and Rs. 120 crores. We could get to about 2.5x.

Shailee Parekh: Okay so the peak revenues that we can generate from there are about Rs. 100 crores to Rs. 120 crores?

Sanjay Shah: Right.

Shailee Parekh: And my other question was I think the LED business is something that does not get spoken about much. Can you throw some light on that part of the business?

Sanjay Shah: So, that is going on at a regular pace.

Shailee Parekh: I mean what kind of growth are we looking at over there or can you throw some more light on that?

Sanjay Shah: I do not want to get into an individual number in terms of a customer because it will not be right for me to do that. But it is growing at a normal pace is what I would say.

Moderator: Thank you. As there are no further questions from the participants, I would like to hand the conference over to Mr. Sanjay Shah – Chief Strategy Officer for closing comments.

Sanjay Shah: Thank you everyone for joining the call. With our continued long term association with our clients and robust order pipeline we are confident to continue to deliver superior performance. Thank you and we hope we have been able to answer your queries. For further information request you to get in touch with SGA, our Investor Relation Advisors. Thank you once again.

Moderator: Thank you very much, sir. Ladies and gentlemen, on behalf of Shaily Engineering Plastics Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.