"Gulf Oil Lubricants India Limited Q1FY17 Earnings Conference Call"

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MANAGEMENT: **MR. RAVI CHAWLA – MANAGING DIRECTOR, GULF OIL LUBRICANTS INDIA LIMITED**
MR. MANISH KUMAR GANGWAL – CHIEF FINANCIAL OFFICER, GULF OIL LUBRICANTS INDIA LIMITED
MR. VINAYAK JOSHI – COMPANY SECRETARY, GULF OIL LUBRICANTS INDIA LIMITED

MODERATOR: **MR. PRASHANT TARWADI – AXIS CAPITAL**

Moderator Ladies and Gentlemen, Good Day and Welcome to the Gulf Oil Lubricants India Limited Q1 FY17 Earnings Conference Call hosted by Axis Capital 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 an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Prashant Tarwadi of Axis Capital Limited. Thank you and over to you, sir.

Prashant Tarwadi: Hi. Good afternoon to you all. On behalf of Axis Capital, I welcome all participants on the Conference Call of Gulf Oil Lubricants India Limited. Today, we have with us Mr. Ravi Chawla – Managing Director; Mr. Manish Kumar Gangwal – CFO; Mr. Vinayak Joshi – Company Secretary. They will start with the overview of the Company's performance for the current quarter and then we can later switch to question-and-answer session. Thanks a lot and over to you, Chawla sir.

Ravi Chawla: Thank you, Prashant. Good evening to all the ladies and gentlemen on the call. This is our Quarter 1 call. I am very happy to share that it has been one of the best quarters for the Company in terms of operational and financial performance, and extremely gratifying for us as a team to see the all-round strong quarter one performance which has been achieved due to the strategic, brand, distribution, and customer acquisition initiatives. So it gives us a lot of pleasure to see that these are working very well for us to start off this financial year.

The numbers which we have released last evening – the Company has received record growth, 23% revenue growth, our EBITDA margins have crossed 17%, both records and of course we are reporting the first time ever highest profit after tax which has now crossed Rs. 31 crores, a strong growth of 52% over last year quarter, year-on-year.

Definitely for us, the things that have helped is the double-digit volume growth and this has been the highest. Volume growth we have achieved at 30% in this quarter-over-quarter last year, so we have touched approximately 22,000 kl for quarter one and this is over last year quarter one which was around 17,000 kl. The main volume growths have come, as I mentioned, across all channels and across all segments that we do business in B2C and B2B.

Our B2C which is around 65% of our business, last financial year was growing at a low single-digit. We are happy to report that that has grown by double-digit and all these segments which we are focusing on have also done very well, the motorcycle, PCMO has grown 20%, HDDO also has gone into double-digit. So that is really showing that the initiatives that we have taken in terms of our distribution and other initiatives are doing well. So both our distribution in urban and rural areas has gone up significantly in quarter one.

The direct business, the B2B business has also recorded a double-digit volume growth both in the direct industrial segment, the OEM factory fill and the OEM dealerships. We also had a new

OEM where we started business that is Swaraj, in the tractor area, which got added in this quarter which has helped.

And the third factor for our volume growth has been an institutional order in the bulk lubes category. But I would like clarify here that the institutional order has helped us grow to 30%, but even without the institutional order we have a very significant growth of 16% in volume and 15% in revenue. And really compared to the industry which we believe is growing low single-digit, 1% to 2% to 3%, so this is certainly the quarter one has been very gratifying quarter for us.

Again, channel sales as I mentioned, which is our B2C, has grown double-digits, which is again nearly 3x of what we anticipate the industry growth to be. We have continued very strongly in our brand building efforts. The successful campaign which we had with Dhoni and the bikers what we call 'Pickup my Ride', last year we had a second burst and we combine this with the consumer promotion in the MCO category.

Our visibility programs continued this quarter along with IPL where we are sponsoring the Pune Rising Super Giants. We added radio advertisements for the LCV segment which is also a growing segment and also a campaign for the agri segment which really helps because the monsoons are also going well, so really a precursor to that in terms of building our brand in this segment.

New products, the marketing team has launched a synthetic oil, another synthetic oil called Power Track which has been launched in the synthetic motorcycle oils for the high end bikes. And a very good offering in the PCMO which is a passenger car called Multi G+ which has raised our specifications at the base level of what is demand in the market.

So, I think all in all we have had a good quarter. Manish, of course will fill in with a few more financial details. But I just like to update all the people on the call that our Chennai plant construction work has started and that is also progressing very well and we expect that to complete that schedule in quarter two of 2017-2018.

Thank you so much. I will hand over to Manish to cover a few details on the other financial highlights.

Manish Kumar Gangwal: Thank you, Ravi. Good evening, everybody. As Ravi mentioned, a very good quarter for us overall. We have been able to achieve 23% revenue growth and as Ravi mentioned that even without institutional order this is 15% which is really good. And in terms of gross margins, also we have been able to improve from last year quarter one to this year quarter one there is an YoY improvement of nearly 3%.

And even at the EBITDA level we have been able to grow nearly 2% over last year June quarter, so we have been able to translate 3% of gross margin improvement into nearly 2% at EBITDA level which we have been talking about in the previous calls that with the operating leverage coming in the translation to EBITDA happens at a faster pace. So that is one good thing which has happened.

Margins wise, we have been able to maintain and expand the margins at EBITDA levels further, even from March quarter and we are at 17.1%. Company has delivered quarter one EPS of Rs.6.29 per share and that is very healthy. ROC, ROE for the Company continues to be excellent in the upwards of 50%. Mix remains the same as it was in March, in spite of institutional order being there.

So these are all positives which the Company has been able to deliver in quarter one. Financial performance has been overall very-very satisfactory for the Company.

And with this background, we can take the questions now.

Moderator: Thank you very much, sir. Ladies and Gentlemen, we will now begin the question-and-answer session. We have the first question from the line of Nitin Mehta from Lucky Investment. Please go ahead.

Nitin Mehta: Sir, my question to you is that you did mention about those institutional orders, how big was this order which you executed in Q1?

Ravi Chawla: Well, as we mentioned, this order partly we had executed last year also, so close to 2,000 kl was the order for this quarter, and total volumes we have achieved in this quarter is 22,000 kl.

Manish Kumar Gangwal: 2,500 kl to be precise. So 19,500 kl is the normal volume and overall is 22,000 kl.

Nitin Mehta: Now sir, we have had a great quarter with all round improvement in gross margins and EBITDA margins, we have seen some 300 basis points improvement in gross margins, so would you attribute this to base oil and product mix, so how much of that would be base oil and how much of that would be mix?

Manish Kumar Gangwal: So, gross margin is a combination of both, so realizations have been fairly stable, so this we can primarily attribute to cost at gross margin level.

Nitin Mehta: And this Chennai plant, what would be the total capacity of that plant?

Ravi Chawla: It would be about 50,000 kl.

Nitin Mehta: And sir, we seem to be growing more than the industry, this year we have recorded handsome volume growth, Q1. So what is our market share, as it stands today?

Ravi Chawla: So, our bazaar market where we have about 65-70% of our sale has crossed about 7% now, i.e. across various segments. And overall if we take the automotive and industrial, we do not do process oils and white oils. Our combined, if you take the whole kitty of 1.6-1.7 million metric tons which is the market, we would be around 5%.

Moderator: Thank you. We have the next question from the line of Tarun Lakhotia from Kotak Securities. Please go ahead.

Tarun Lakhotia: Sir, I just wanted to dig more on the volume growth part, so could you just elaborate on the factors which you think are driving the kind of volume growth which we have seen in the recent quarters? Do you see that there is a secular pickup in demand environment or is there something to do with some improvement in OEM sales which may taper off probably going forward?

Ravi Chawla: So, all the businesses that we are presently there in, we have seen a growth in each one of them. So the channel business for us, we do not see major, we see some pickup in the personal mobility segment in the market, but along with the initiatives that we have put in distribution, whether we talk of distribution in urban or rural and new products we are launching, the kind of initiatives we have taken on the ground, both brand building and below the line, certainly as we always say, we are looking at two to three times the market growth. So that has been successful for us in the channel business.

We have seen growth in personal mobility car, and in the car segment we have got initiatives where we are gearing up our portfolio and we are looking at increasing our distribution, increasing independent garages we are taking on as car stops, there we have seen a 20% growth for our segment, our PCMO products. In addition to that, I would say the diesel engine oil which we have right across our channel and in our dealerships, even there we have now seen a double-digit growth.

So the businesses are growing, our strategy, as I mentioned, it is gratifying to see that some of the medium and long-term strategies which we are working on the last year or so, we see them now really paying off in a bigger way, these have been always growing. So that is really gratifying for us. And similarly in B2B, you are right, OEM factory fill has gone up, we do only factory fill for a few of the OEMs. OEM dealerships are going up, we have added new dealerships with Mahindra and the Swaraj brand. So most of the segments, I can even add here the infrastructure road segment in which we supply has grown positively, as you know the number of roads and metros being built are going up, we cater to a large number of customers there.

And lastly I would like to say the marine business where the Gulf oil has presence since 2008 globally with the Gulf Oil Marine, that business also we have been seeing that Gulf is able to win customers who are domestically in the shipping industry and we have also grown quite well in those segments.

Tarun Lakhotia: Sir, two follow-ups on this bit, one is, you have always maintained that your intent is to grow 2x to 3x of industry and we have seen that you have delivered it over the period of time. So 16%

growth in this quarter, I mean excluding that specific institutional order, does it imply that industry growth has picked up to 5% - 6% at least as compared to probably 2% - 3% which was the case?

Ravi Chawla: So our anticipation is that normally industry growth is 1% to 3%, maybe bazaar is 1% higher, so that is our anticipation.

Manish Kumar Gangwal: And when we talk of 2x to 3x, Tarun, we talk it on a annual basis. So some quarters it may be really good depending on how much the trade was stocking also. So at the end of the year, we always try to deliver 2x to 3x the market growth.

Tarun Lakhotia: Last thing, are you seeing any, I mean, is there some section of industry where you think they are losing market share clearly to PSUs or some private players? I mean, the reason why I am asking delving more on this is because we have seen also some improvement in volume growth for one of the larger private player, the industry leader. So I just wanted to understand, is there a pickup in the industry wide or is there some shift in market share which is happening which will impact the volumes going forward?

Ravi Chawla: No, I will reiterate, the market growth has picked up from last year by 1% or so, but certainly for us to grow this kind of volumes, our strategies are working, I would say, much harder and much better on the ground. So there is some market share gain which would be coming, it is difficult to say which segment where, of course we have plans, maybe offline we can share a bit, but it is obviously that there is some market share gain coming for us, and other players if they are also getting.

Moderator: Thank you, sir. We have the next question from the line of Raj Gandhi from Sundaram Mutual Fund. Please go ahead.

Raj Gandhi: In this institution order, what is the occurrence of that, as in, just one time or…?

Ravi Chawla: No, it is periodic, but I think so far we get orders from various, even state transport undertakings and others. So this is a bidding process, so this is not recurring, so you have to bid for the next order in terms of the price and then win it.

Raj Gandhi: So, how big is this, we were not present in this segment in a big way before a year or something?

Ravi Chawla: No, we have been periodically in the past also sometimes getting a bite at this order, but this quarter it has been a good volume.

Raj Gandhi: Any particular target, how much growth do you think to get from this segment this year, next year?

Ravi Chawla: It is a tender based thing, so normally we do not like to budget for that unless it happens, because it is obviously related to a competitive price bidding and all that.

Raj Gandhi: Because now, let's say, an OEM factory or state bus undertaking or something where you have bided a lower price or something, relatively, does it have an impact on your other OEM tractor sale or any other segment in terms of, then the user is asking for a better pricing or something?

Ravi Chawla: No, there is no relation to that. And this order we got, I mentioned state transport undertaking, this is a government order, nothing to do with state transport. But we also provide to state transport, I was just giving an example. So that is no relation to OEMs.

Raj Gandhi: And if I were to say, despite of this order your realization does not seem to have got impacted much in that sense, so was it a particular, let's say something like synthetic oil and all which generally then did not, because of which it did dent your overall realization as much or it was, just to get a…

Manish Kumar Gangwal: No, so this is diesel engine oil category, bulk lube category. So our realization and gross margin would have been slightly better if this order was not there, but in the end every order contributes to the bottom-line. So that we always take as and when there is an opportunity.

Moderator: Thank you, Mr. Gandhi. We have the next question from the line of Vinod Bansal from Franklin Templeton. Please go ahead.

Vinod Bansal: Couple of questions, one, continuing on this order on the bulk order, at what frequency does this bidding happen? I mean, you have been doing a little better in the last three quarters on this front compared to your earlier quarters, so at what frequency does this bidding happen and how sustainable that looks like to you?

Ravi Chawla: See, these are orders issues on an annualized basis by the authorities, so it is just as we mentioned earlier this would all depend on the bidding process and obviously where we want to bid. So these are not recurring. In fact, when we talk about our growth plans, these are additional. So as we mentioned, even without this order our growth is 16% volume which is well, we would say that we normally get a double-digit growth, and this is a good, 16% is a mid-sort of growth. So definitely quarter one has been helped by this order, but without this order also 16% for us is much above the market growth rate as you know.

Manish Kumar Gangwal: And Mr. Vinood, you see, the timing of the order that came was such that a part of it was supplied last year and part of it was supplied in quarter one, we do not have any further pending order as far as this government order is concerned as of now.

Ravi Chawla: Yes, and the prevailing cost situation also, if you see the timing of the order has been a good timing for us in terms of cost of goods, which you will agree on.

Vinod Bansal: So, you are saying that the bid that you won last year, the tenure of that bid is over now by end of June?

Ravi Chawla: Yes, but as we clarified many times, we continue our business model, clearly focused on our B2B, B2C segments, this is additional which comes in B2B but it is annual and this process, I would say over the last three, four years, we would do it once in two years, this would be kind o coming in, but we do not know the future, because again as I mentioned, this is a tender based business.

Vinod Bansal: So, I do not know, maybe I am repeating something that you may have answered already, does that get into bidding again immediately in July, August?

Ravi Chawla: So every six months or seven months it comes into bidding.

Vinod Bansal: And what kind of competition do you see here, I mean what kind of pricing cuts you have to take to win orders?

Ravi Chawla: So like in any tender government business, the pricing is very important. So we have to look at the product range and based on the product range and with our strength we would then quote the pricing, everything is not, pricing and also a bit of the products have to go through certain tests, so once you go through these tests and pass all those parameters, then you have to take a judgment and decide what you want to go in for a quality product or the mass based products, so it is a mix of both.

Vinod Bansal: Can you share with us what kind of pricing, how lower the pricing for this order was compared to initial pricing?

Ravi Chawla: So, that level of pricing is available in government documents, if you want, offline I can give it to you, not a problem.

Vinod Bansal: Sure, I will check it offline. The other thing is, I presume the distribution cost would be lower for such large scale orders, if that is right then your operating cost per unit should be going lower, it is not, it is stuck in that 40 per liter range, what is driving that?

Manish Kumar Gangwal: See, these kind of orders, again as we mentioned, are government supplies where we have to deliver to their each depot across various parts of India, so the distribution cost is similar to what our channel business would have, in terms of freight, etc, of course the commissions etc, trade discounts etc will not be there, but distribution per say, freight would be slightly higher because this has to reach to even hilly regions, etc. But we have been able make decent margins in this business which has helped our bottom-line.

Vinod Bansal: So, as a strategy you continue to bid for it as long as it is covering your costs and little more?

Manish Kumar Gangwal: Yes, that is right.

Vinod Bansal: So any guess you would like to hazard, what kind of volumes you can do for the year now, given that this order has to repeat itself, including that or excluding that, what kind of volumes can you look forward to?

Ravi Chawla: No, we have been very clear that whatever, just for some time let us forget the institutional order because this is something which happens, as we said, periodically. Given the markets we are in and the segments we are in, we look to grow, whatever industry is growing, 2x to 3x. So certainly that has been a benchmark for us and we have done that. And in certain segments where we are highly focused, we are looking at a more positive growth there and we are also looking at new customer acquisitions, whether it is increasing distribution outlets or increasing B2B customers and segments we are playing or when we talk about the OEMs. So currently our focus is completely on that and how we can increase that.

Vinod Bansal: So just one last question from my side, so in the car market you had launched a product some time back on which you had launched three variants I suppose, of which I believe you have launched two products within that bigger car product. What next in line in terms of product launches for you this year?

Ravi Chawla: Yes, so we have launched two, three products, so we are again launching a few more car products which will come in the top end and we are planning one or two more in the motorcycle segment, so these are the launches planned for this year.

Vinod Bansal: And you would have pretty much filled the gap, let's say with industry leaders in terms of product availability, segmentation after these launches?

Ravi Chawla: Yes, in the car segment we would have, otherwise the rest of our segments have equivalent products which are already there.

Vinod Bansal: So across product ranges you would have pretty much filled the gap with…

Ravi Chawla: We already had, in the other segments we had all the range, in the car we have kind of refurbished our range and one or two gaps over there which we are plugging.

Moderator: Thank you, Mr. Bansal. We have the next question from the line of Priyank Chandra from Dolat Capital. Please go ahead.

Priyank Chandra: Just one question, sir, how has been your distribution expansion happening as compared to the last quarter fourth quarter FY16 as compared to this quarter?

Ravi Chawla: So, what we do is we look at a figure of say 10% to 12% increase in distribution annually which is what we look at in terms of outlets, but we are happy to share that first quarter we have seen nearly a 4% to 5% increase in our distribution.

Moderator: Thank you, Mr. Chandra. We have the next question from the line of Sabri Hazarika from PhillipCapital. Please go ahead.

Sabri Hazarika: Sir, just want to clarify, your volume for Q1 was around 21,500 kiloliters, right sir?

Ravi Chawla: 22,000 kiloliter

Sabri Hazarika: 22,000 kiloliter, of which 2,000 kiloliter was from this one time institutional order?

Ravi Chawla: 2,400 kiloliter approx.

Sabri Hazarika: And remaining 19,500 kiloliter, so what is the division between industrial and automotive on that?

Manish Kumar Gangwal: That continues to be in the range of 65:35 without this bulk order.

Sabri Hazarika: 65 is auto and 35 is industrial, okay. And you said that you have recorded double-digit growth in all the three categories in automotive, that is PCMO, DEO as well as motor cycles, so how much would it be, what range of double-digit is it?

Manish Kumar Gangwal: So as Mr. Ravi mentioned, PCMO we have already mentioned that we have grown 20%, DEO will be double-digit, so you can take that figure.

Sabri Hazarika: Low double-digit, right?

Manish Kumar Gangwal: Yes. And MCO is mid teen double-digit .

Sabri Hazarika: Sir, basically it is in 10% to 20% range?

Manish Kumar Gangwal: Yes, that is right.

Sabri Hazarika: And sir, just wanted to know one question on the industry, like we have seen very significant growth in petrol and diesel consumption in the last two years, so is it not percolating to higher lubricant usage or is there something else which is like curtailing the growth rate, like further increase in drain intervals or do you think that drain interval have peaked out or it should not be going up any further?

Ravi Chawla: See, the trend of the overall industry has been that even if you study the Kline studies and whatever we see, the overall industry is expected to grow around 2.5% if you go forward, but last three years we have seen negative and very low increase, 1% to 2%. So our estimate now is and we do get our reports, even secondary reports that this 1% or 2% would have gone up maybe 1% or 1.5% in bazaar. So we are seeing some positive things, definitely personal mobility and we are also hoping to see some increase in the DEO segments, if the monsoon is good than tractor consumption of lubricants will be higher. And we have seen positive consumption definitely in the road building construction equipment.

So we are seeing a positive improvement in the market growth. But as you also mentioned, because of long drain intervals and all, they will not grow in line with the vehicle population and economy picking up, mining opening up, more growth, more movement of vehicles, that again can only help, so that will also move along when GDP goes up. But in this industry, because of long drain and higher technology, even if we see that GDP picks up, because of longer drain oils at least a climb, which experts have predicted, of 2.5% for overall industry and the PCMO or personal mobility is higher, 3% to 4%. So that is really how the growths in broad top level look like.

Sabri Hazarika: So what is the average drain interval, I mean the realistic drain interval among…

Ravi Chawla: That is very long, you can come off line, but each segment has a different drain interval, it depends on the categorization in terms of the segment.

Sabri Hazarika: For example, in CV is it still at 35,000 kilometers or has it gone up any further?

Ravi Chawla: No, see CV in 2006 used to be around, we anticipated around 16,000 to 18,000 kilometers and that has certainly gone up to around 35,000 - 40,000 kilometers.

Sabri Hazarika: That was like in the last two years?

Ravi Chawla: No, 2006 to now, so it is going up, as we speak, as we say every year it goes up.

Moderator: Thank you, sir. We have the next question from the line of Sanjeev Panda from Sharekhan. Please go ahead.

Sanjeev Panda: The growth that we got this time, how much would be contributed, if you can quantify, from the new products that we have launched, that is the incremental that you have got from the new launches?

Ravi Chawla: So, we would say about 1.5% of the growth is coming from there.

Sanjeev Panda: And second, considering the crude prices bounce from at least, for the time being it seems to be from the $30s level to $45 - $50 level, and in this scenario how do you see the input cost for us and how it is happening in terms of competitive pricing at this point of time within the players?

Ravi Chawla: Can you just repeat the question again, I am sorry I missed.

Sanjeev Panda: I said, the crude benefit was there in the last year, but then it has come back tom $35 level to around $45 - $50 level, in this scenario how it is happening, what are the things, if you can give some color how it is happening in terms of pricing among the competitive players?

Ravi Chawla: You are talking about pricing or…?

Sanjeev Panda: Yes, pricing.

Manish Kumar Gangwal: So you are right, base oil with a lag effect follows crude, but last two year we have seen that of course crude has gone down from last to last year from $100 peak to $30 low, nearly a 70% fall, but base oil has not fallen 70%. So there is a bit of disconnect also happening and the disconnect is getting wider by the grades because each grade is following now a different trend depending on demand and supply. So it's not a very direct co-relation, yes, there is a co-related but it's becoming very distinct now, it is getting blurred. At the same time, you are right that from the lows the crude has gone up from 30s to now around $42, so base oil also from the lows has gone up in the last quarter. Obviously everybody carries some inventory so effect will be coming slowly and gradually. So far there is no competitive action on the pricing, pricing has been stable but nobody has really taken the pricing up as well, that is what we can say at this moment but what will happen tomorrow it is anybody's guess as yours and mine.

Sanjeev Panda: How was it in the last time whenever the input prices have shown similar kind of pattern in the past in the history?

Manish Kumar Gangwal: That's an interesting point. What we have seen that industry has typically retained a certain margin levels, so if you will go back to the history of 2009 when the crude had fallen typically industry retained margins and then that kind of margin levels were retained for the next 3-4-5 years till another opportunity came to take the margins up which happened in 2015-16 and is continuing. So typically industry has retained a good part of the margin which it has been able to reach.

Moderator: We have the next question from the line of Mr. Harshal Mehta from ICICI Securities. Please go ahead.

Mayur: Mayur here. On the cost front how much increase in base oil cost we might see in the coming quarters because this quarter also we did not see a substantial increase in the cost so coming two quarters we will see an increase in the costs?

Manish Kumar Gangwal: Marginally yes. How much is a very difficult question because everybody carries inventory, we also carry inventory so in that will be gradual as I mentioned for the previous question but definitely there is an increase happening and pricing scenario also has to be watched, so industry typically retains the margins but we have to see really the competitive action.

Ravi Chawla: So just to extend as a strategy what industry sees is that if the prices go up significantly then immediately you see either the schemes of the discounts coming down and then correction taking place in price and there we see that the industry has been quite disciplined so we are hoping that that continues.

Mayur: Last year how much was the institutional volume that we did out of 75 million liters, how much was the institutional volumes?

Manish Kumar Gangwal: Roughly 2200.

Moderator: We have a follow on question from the line of Raj Gandhi from Sundaram Mutual Fund. Please go ahead.

Raj Gandhi: Possible to highlight what would be your spot purchase cost versus the Q1 cost? For base oil what will be the current spot purchase cost versus your Q1 average cost?

Manish Kumar Gangwal: Very difficult. As I mentioned the price will vary from grade-to-grade, more to local purchase. From term prices to spot buying again, so very difficult to say but there is a definite increase in the base oil from what it was in the lows of February-March which obviously we carry inventory so had a less impact in Quarter 1, will have slightly more impact in Quarter 2.

Raj Gandhi: Possible to give some clue on a blended basis? As you were saying from term you move to more spot imports and all, so just on a blended basis net net after all the attempt to just contain it, what kind of percentage increase can we expect?

Ravi Chawla: These are very honestly pricing decisions also which we take on a monthly basis. We would not like to reveal our spot because honestly we have to see competitive pricing also.

Manish Kumar Gangwal: Typically industry retains margins in a band which we have already highlighted.

Raj Gandhi: Obviously for you because you are an institutional order margin will be to that extent it will help margin in the next quarter but on a like to like basis margins will go down because I would assume then from what you are saying they are higher end of the band right now which could move at the lower end of the band in the coming quarter, will that be correct?

Manish Kumar Gangwal: It will not happen in one quarter straight because the pricing every time you buy you will average out, it is a weighted average cost, prices have not gone up in one single month, it has been gradual and you will remember that crude had hit a $52-53 recently it has come off now $42, and pricing of certain grades have come up also as we speak in the highs. We've just one grade which has reached up to $970 had come back to $870 per ton. So there is a bit of fluctuation happening everyday nowadays, very difficult to say but weighted average increase will not be so sharp to effect one quarter straight away.

Raj Gandhi: This institutional order that you got, generally whenever you bid for any state transport unit or a government, is it a fixed price order of base oil price is a pass through, how does it work?

Manish Kumar Gangwal: It's a fixed price order.

Raj Gandhi: When did you bid for it? The order which you executed right now when had you bid for it?

Manish Kumar Gangwal: 2015-2016.

Raj Gandhi: Would it be right to assume that had the base oil not corrected so much during this quarter, the margins would have been much lower on this government order? You got benefited in this government order this time around because the base oil prices fell quite drastically this quarter?

Manish Kumar Gangwal: We keep a certain margin while quoting and the delivery has been more than what we quoted for obviously because the base oil price came down. We never quote a tender without margin.

Raj Gandhi: Which month did we bid?

Manish Kumar Gangwal: Very difficult because it takes a longer cycle in government order. I assume it would be some time in Quarter 2 last year. We started selling this or supplying this from Quarter 3, partial quantity was in Quarter 3 then in Quarter 4 and Quarter 1 this year.

Moderator: We have the next question from the line of Ankit Jain from Mirae Asset Global Investments. Please go ahead.

Ankit Jain: Within automotive segments what could be the volume breakup across PCMO, DEO and MCO?

Manish Kumar Gangwal: Mix remains the same as it was in previous quarters largely with a bit of further improvement in the personal mobility which is MCO and PCMO.

Ankit Jain: Can you give a number?

Manish Kumar Gangwal: We have been mentioning in previous calls that for us PCMO is close to 4-5%, MCO is close to 19-20% and there is diesel engine oil as far as automotive category is concerned and there are industrial products also.

Ankit Jain: Another thing on this discounting or dealer schemes have we seen any increase Q-on-Q basis? Any sort of dealer incentivization might have gone up?

Manish Kumar Gangwal: You are talking about the industry?

Ankit Jain: For the industry as well as us.

Ravi Chawla: Each of the players obviously have their own strategy, ours has been more we are now as mentioned in the initial part of the call also our strategic initiatives have been more around building the brand distribution and obviously there is a dealer normal policy which we have annually which we release and there is a quarterly sort of incentives we give but some of the competition we have seen that they have increased some schemes, so we would say that there is no major impact but some competition has really stepped up some of their schemes in certain products.

Moderator: We have the next question from the line of Vinod Bansal from Franklin Templeton. Please go ahead.

Vinod Bansal: Why doesn't the drain interval go up in personal mobility segment in the cars, etc., why does it go up only in CVs?

Ravi Chawla: The question is that the OEMs who drive the drain interval for cars are also working, they have specified drain interval but really as you will appreciate the gain to a commercial vehicle is a cost of maintenance and cost of ownership so that is a really critical one for a truck owner. For car the OEMs tend to dictate what is the drain interval so that is been at a certain level, for example, that used to be 3000 it's now 5000, so it's not really moved up as much as commercial vehicles. And similarly motorcycle whatever happens in the OEM workshop again is linked to a certain recommended interval but if you see the bikes getting changed outside in the open market the mechanics tend to try to change it more often because they also have an incentive in that. So these two both the car and bike tend to be less more of time related, sometimes people say we change once in three months, OEMs of course have a certain cycle but it's not really been going up so much in terms of drain interval.

Vinod Bansal: I didn't get that. You are saying in CVs if the customer is extremely cost-conscious about the maintenance part of it therefore it incentivizes OEMs to make products that…..

Ravi Chawla: Yes, it becomes a good proposition to say that you'll be able to use this oil for 30% more life, so it gives him life also and therefore gives him a benefit also in cost of ownership. In the case of a car the involvement of a lubricant, like if you have car your involvement in the lubricant is also slightly low, you would like to have more peace of mind and change it as per the service interval, so that's really how the consumer behaves.

Vinod Bansal: But the cost of the lubricant in overall cost of consumption fuel less maintenance whether it is cars or CVs would be same on a percentage basis, isn't it?

Ravi Chawla: Commercial vehicles are running more so as a percentage, Yes, you can do the percentage calculation for a commercial vehicle would be far higher, they would be consuming more in terms of fuel and lubricant.

Vinod Bansal: I get the point. I am saying the lubricant cost as a percentage of total fuel cost that percentage would remain the same for both CVs and cars?

Ravi Chawla: You are saying lubricant versus fuel?

Vinod Bansal: Yes.

Ravi Chawla: Supposing you were to fill 100 liters of fuel and you would need every month but the question is the commercial vehicle would use far more fuel and then of course the lubricant is also used. Yes, in a way you are right that percentage I think we will have to take this off-line to explain to you.

Vinod Bansal: Last quarter call you had explained that while electric cars are not such a big risk at least in India can you share some insights on how your counterparts globally in Europe, US and other developed markets are responding to it? Are they investing in new products, new businesses or they are also not seeing it as seriously?

Ravi Chawla: I think the way we are seeing globally is that though we hear a lot now that the electric cars are coming in but we are not seeing any major change in terms of any concrete strategy in terms of what you are addressing that is there a change or shift in some for the lubricant players.

Vinod Bansal: On the Chennai plant, could you once again specify what kind of cost benefits would you see once you start operating your South facility in terms of distribution?

Manish Kumar Gangwal: The straight cost benefit will be to our freight because 30% of our sale is in Southern part of India as you are aware of. We will straightaway be saving on the freight cost there. We will be moving closer to OEMs, Chennai is an Auto hub; so one of the strategic reasons to shift to Chennai or making a new plant in Chennai has been to reach near to OEMS.

Vinod Bansal: In terms of freight cost can you specify some quantitative number what kind of benefit per liter you could see on the overall sales?

Manish Kumar Gangwal: Chennai as we mentioned is close to 30% of our sale will goes currently from Silvassa and the average freight for would be Rs. 5 a liter currently, Rs.4.5 to 5 and locally it will be Rs.1. I'm just giving the example. These are ballpark figures. You can do your maths in terms of overall saving potential we are looking at once Chennai starts operating.

Moderator: Thank you Mr. Bansal. We have a next question from the line of Prayesh Jain from IIFL Wealth. Please go ahead.

Prayesh Jain: PSU companies like the OMCs are in a very good health now and considering the deregulation. And one of the companies has always mentioned they are amongst the leaders, the HPCL particularly. So are you seeing aggressive competition from PSU companies coming in now and with the health getting better you might see more pressure on pricing on that front?

Ravi Chawla: We are not seeing anything majorly in the market. Certain segments like the government tenders and all where they dominate there we have seen some lower pricing from them.

Prayesh Jain: In terms of majority of the base oil would be imported, right?

Ravi Chawla: Depends but Yes you are right majority is imported.

Prayesh Jain: How would you hedge your dollar fluctuation in that sense?

Manish Kumar Gangwal: We have a well-defined board approved policy on hedging which is designed by FOREX experts and we follow that which effectively translates into close to 50% hedging at any point in time.

Prayesh Jain: For the dollar exposure?

Manish Kumar Gangwal: For the dollar.

Prayesh Jain: And also for the pricing of base oil, you also hedge that?

Manish Kumar Gangwal: No.

Prayesh Jain: Chennai what was the total CAPEX and how much have been incurred so far?

Manish Kumar Gangwal: We have a CAPEX of close to 150 crores and we have incurred already 40 crores out of that online. And incremental cash outflow expected is roughly 110 crores over a period of next 15 to 18 months.

Prayesh Jain: When is this expected to commence operations?

Ravi Chawla: Towards the end of Quarter 2 of next year.

Moderator: Thank you Mr. Jain. We have a next question from the line of Nitin Tewari from Antique Limited. Please go ahead.

Nitin Tewari: How do you think the passage of GST is going to impact the industry and our business for that matter in terms of pricing, in terms of sales or in terms of logistical requirements so if you can throw some light on that?

Ravi Chawla: It's going to be positive; I think both on the procurement side and for us also definitely saved in terms of the movement of goods and distribution cost. In all piece three areas we see it as a positive and welcome change.

Nitin Tewari: As you would be aware that the taxation would also change so how would that impact pricing in the lubricants space as such because I believe the final pricing would ultimately be dependent on the tax which will be charged, so do you foresee like prices coming down because of that and that helping sales in any way something of that sort?

Manish Kumar Gangwal: Nitin you will appreciate that this will depend on how overall the industry or the competitions are playing their game. But there is a window available, how much of it will be passed on to consumers and all that's only we will have to see as and when the time comes. There is a window available.

Ravi Chawla: I would anticipate that it's a positive for the industry; it's a positive for the market and consumer also both ways.

Nitin Tewari: So it has a more of a positive overbearing.

Ravi Chawla: Yes overall.

Moderator: Thank you sir. We have a next question from the line of Kunal Bhatia from Dalal & Broacha. Please go ahead.

Kunal Bhatia: You mentioned something in regards to synthetic oil which you have induced. Just wanted to know currently what percentage of your portfolio is through that.

Ravi Chawla: We are low single-digit at the moment. But obviously there are the some of these grades we have launched in the last 2 to 3 years, semi-synthetic, synthetic. So we are growing this quite aggressively both in terms of the car segment and two-wheeler segment, so currently its low single-digit.

Kunal Bhatia: How has been the growth over the last 2-3 years' period that you mentioned?

Ravi Chawla: For synthetic oils?

Kunal Bhatia: Yes.

Ravi Chawla: The base has been very low so to look at the growth is literally adding a percentage every year. But we would expect this to grow at least (+20%).

Kunal Bhatia: Just missed out on your sales breakup in automotive, how much would it be passenger vehicles, motorcycles, and CV?

Ravi Chawla: We mentioned that basically our motorcycle is about 19% to 20%, passenger car is 4% to 5%, the balance of course there are some gear-oils and greases but diesel engine oil as you know as an industry if you take overall is close to nearly half the volume or close to half and then we have industrial grids.

Kunal Bhatia: In case of only automotive it will be 19%-20% motorcycle and passenger vehicle would be 4% to 5% and remaining in case of automotive would be completely CVs or is there something else there?

Ravi Chawla: No there is DEO, diesel engine oils go into CVs, they go into construction equipments, they go into tractors, and they also go sometimes into industry so that's where the diesel engine oil portfolio is and balance would be hydraulics and greases and some specialized transmission oils. So typically the industry has about if you see the greases and gear oils make up about 7% to 9% and then the hydraulic oils make up another 7%-8%, if you see about 15% to 20% would be these industrials, so balance is 80%.

Manish Kumar Gangwal: So for benefit of all we can simplify this by saying that if you go by product classification we will be close to 80%-85% automotive product and 15% industrial product and if we go by the route to market we would be 65% B2C, 35% B2B.

Moderator: Thank you. We have a next question from the line of Sanjeev Panda from Sharekhan. Please go ahead.

Sanjeev Panda: As you said our Chennai plant once it will start we can have the benefit of that because of the logistics and other benefits because a significant part of our business comes from that area. So just trying to understand the strategy how management is looking for, in post that the benefit are we planning to make it more retain in the margin side or we would like to be more competitive and gain the market.

Ravi Chawla: The growth plans that we have and the growth that we have been achieving obviously Silvassa is now working at a very high capacity utilization. So given that we wanted expansion product, one option was to toll blend outside which a lot of people also go for. But we believe that making the product in-house not only allows us to get some benefits it also improves the quality and the image and also can give us better service to our customers. So combining this and also seeing that we had a strong South market it made a lot of sense because straightaway as Manish explained there is a freight saving. So our strategic reason to put up Chennai is to also make a plant having because we are looking at new OEMs, also servicing our current OEMs better, so certain cost efficiencies will help us to get new customers, certain cost efficiencies will help us to serve the customers better. At the same time, we are looking at both volume market share growth and maintaining our profits. So I think all in all it falls in very place. So supposing you get a new OEM close to Chennai and we find that we can service him much better than a competitor and give them a better price and increase our market share we would go for it. Secondly you would also look at servicing customers better who can give us a better price for our product. So I think it's both a mix of volume, market share gain, and look at our own profitability including when you make the product in-house both the quality and when the OEM usually signs you on they want to make sure that you have got a world-class facility so that also will help to attract more customers to us.

Moderator: We have a last question from the line of Manav Vijay from Peerless Mutual Fund. Please go ahead.

Manav Vijay: I had one question on GST. You mentioned that it will be beneficial for the industry because of the procurement benefit, so let's resume that let's say the GST rates comes out to be 20%, so possible to put let's say what kind of percentage benefit, 2%, 3% is possible which whether industry decides to retain with themselves or to decide to pass on to the customer, that a separate, but what kind of benefit is possible?

Manish Kumar Gangwal: If you are tracking the lubricant industry is currently at 14% excise duty, then we have VAT in different states and which are at different rates and both will get subsumed into one GST, which is as per your example is 20%, the differential is today pretty large. 14% excise plus average if we take 13% VAT which is 27% and 20% so there is a window of 7% to 9% available depending on states and geographies which we will have to be decided or pricing we'll take care of as and when we really go into that scenario.

Moderator: Ladies and gentlemen, due to paucity of time that was the last question. I would now like to hand the floor back to the management closing comments, over to you sir.

Ravi Chawla: Thank you Prashant. Thank you everybody for being on the call. We appreciate your time and really appreciate the questions which also helps us to look at how we are running the business and improve. We have obviously seen Quarter 1 come out strong and as I said a strong start to give us a momentum so internally we are quite positive. We are definitely sure that with a good monsoon and economy things are going to improve and strategically we are surely making our strategies more robust and also flexible in terms of adapting to whatever is going to be ahead whether it is crude oil pricing or the GST coming. And certainly look at a positive next quarter to focus on and continue to build on our key strategies. Thank you once again for all your time and appreciate. Thank you.

Moderator: Thank you sir. Ladies and gentlemen, on behalf of Axis Capital Limited that concludes this conference. Thanks for joining us. You may now disconnect your lines.