"Balkrishna Industries Limited Q2 FY23 Earnings Conference Call"

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MODERATOR: **MR. AMAR KANT GAUR – PHILLIPCAPITAL (INDIA) PRIVATE LIMITED**

Moderator: Good morning, ladies and gentlemen. Welcome to the Q2 FY23 Earnings Conference Call of Balkrishna Industries Limited hosted by PhillipCapital (India) Private Limited.

This conference call may contain forward-looking statements about the company, which are based on the beliefs, opinions and expectations of the company as on the date of this call. These statements are not the guarantees of future performance and involve 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. Amar Kant Gaur from PhillipCapital (India) Private Limited. Thank you, and over to you, sir.

Amar Kant Gaur: Thanks, Lizann. Good day, everyone. On behalf of PhillipCapital (India) Private Limited, I welcome you to the Q2 FY23 Earnings Conference Call of Balkrishna Industries. I would also like to thank the management for taking out time for this call. Balkrishna Industries is represented by Mr. Rajiv Poddar, Joint Managing Director, and the senior management team.

As usual, we will start with the review of the quarter by Mr. Poddar, and then follow it up with Q&A. Over to you, Mr. Poddar.

Rajiv Poddar: Thank you, Amar. Good morning, everyone, and thank you for joining us today. Along with me, I have Mr. Bajaj – Senior President (Commercial) and CFO, and SGA, our Investor Relations adviser. Let me begin with performance updates.

Looking at the current global geopolitical challenges, especially in Europe, which is also our biggest market, there are strong headwinds. Despite the challenges during the quarter, the company could deliver a good performance and registered a sales volume of 78,872 metric tons. The current situation in Europe continues to be challenging and thereby may affect our performance in the second half of this financial year.

The demand pattern has been relatively better in Northern America. However, recession fears may also impact the growth rates there.

India continues to be stable supported by a better economic environment backed by good monsoons. However, the global economic weakening coupled with a sharp uptick in interest rates, has also reduced order placements by dealers and distributors.

During this challenging macro environment, we are unable to guide annual sales volume for this financial year. The recent price correction in raw materials and logistic costs bode well for our profit margin. However, as guided, the benefits are expected to kick in from early Q4.

Let me update you on the Waluj plant. The Board had earlier intended to replace the old plant with a newly commissioned Greenfield Plant, but given the subsequent business outlook, it was decided to continue operations at both plants along with the modernization of the old plant.

The Board has now decided to revert to its earlier decision of ceasing operations at the old plant. The earlier approved CAPEX of Rs. 350 crores for modernization of the old plant will now be utilized at the new plant site to bring in economies of scale.

This will be done as a Brownfield project. It is expected to be completed by the first half of the next financial year. The Waluj location will accordingly have an overall capacity of 55,000 tons per annum at a single site.

Accordingly, the current achievable capacity will stand reduced to 335,000 metric tons per annum and will increase back to the original number of 360,000 metric ton by the end of the first half of the next financial year post commissioning of the Waluj Brownfield project.

We have also completed the modernization, automation and technology upgradation CAPEX at our Rajasthan and Bhuj plants. We expect better productivity to kick in gradually resulting in a margin uptick.

The CAPEX for Carbon Black continues to be on track, and we expect the commissioning of the 55,000 metric ton per annum Carbon Black project along with the power plant during December. In addition, the advanced Carbon Black project of 30,000 metric tons will be commissioned during the Q4 of this financial year.

With this, I now move on to the operational highlights:

Our quarterly sales volume was 78,872 metric tons, a growth of 8% year-on-year. The first half of sales volume stood at 162,025 metric tons, a growth of 15% year-on-year.

Our standalone revenue for the quarter stood at Rs. 2,806 crores, which includes realized gain on Foreign Exchange pertaining to sales of Rs 102 crores. For the first half of the year, revenue stood at Rs. 5,533 crores, which includes realized gain on Foreign Exchange pertaining to the sales of Rs. 182 crores.

For the first half of this financial year, 49.6% of the sales came from Europe, 19.9% came from India and 20.3% came from the Americas, whilst the balance came from the rest of the world.

In terms of channel contribution, 69.8% was contributed from the replacement segment while OEM contributed 27.6%, with the balance coming from an update. In terms of category, the agricultural segment contributed to 64% while OTR, industrial and construction contributed to 32.9%, and the balance came from other segments.

The standalone EBITDA for the quarter was at Rs 564 crore with a margin of 20.1%, while for the first half of this year, it was recorded at Rs 111 crores translating to a margin of 20.1%. The high raw material cost has impacted the EBITDA for the quarter.

Other income for the quarter stood at Rs 58 crores while unrealized gains stood at Rs 49 crore. The other income loss on M2M basis suffered in Q1 on the investment book reversed in Q2. Other income for H1 stood at Rs 43 crore, while unrealized gains stood at Rs 75 crore.

Coming to the net Forex items for the quarter, we had a net Forex gain of Rs. 168 crores, which includes realized gain of Rs 120 crore, an unrealized gain of Rs 49 crore. For the first half of this year, we had a net foreign exchange gain of Rs 286 crore, which includes realized gain of Rs 211 crores and an unrealized gain of Rs 75 crores.

Profit after tax stood for the quarter at Rs 404 crore while for the first half of the financial year, it stood at Rs 724 crore. Our gross debt stood at Rs 3,090 crores at the end of 30th September '22 of which about Rs 2,253 crore is related to the working capital debt.

Our cash and cash equivalent were Rs 2,078 crore. We have completed all the CAPEX programs barring Carbon Black . For quarter two of the financial year, the Euro hedge rate was Rs 85. The forward hedge rate currently stands at around Rs 85 levels for the rest of the financial year.

The Board of Directors has declared a second interim dividend of Rs. 4 per share. This is in addition to an earlier interim revenue of Rs. 4 per share for Q1.

With this, I conclude my opening remarks and leave the floor open for question and answer.

Moderator: Thank you. Ladies and gentlemen, we will now begin with the question-and-answer session. The first question is from the line of Siddhartha Bera from Nomura. Please go ahead.

Siddhartha Bera: Thanks for the opportunity. Sir, my first question is slightly delving deeper into your volume outlook for the year. Some of the challenges you have indicated like Europe demand and inflation impressions in North America are, largely similar to what you have guided probably a couple of months back also. So, what changed so much? And despite that we have seen a decent volume in the current quarter as well in Q2. So, just wanted to slightly understand more in the three months, what has changed so much that we are not indicating the volume outlook for the year? Is it more in terms of the near-term weakness you are seeing or you believe that the issues may prolong slightly longer than what expect? So, slightly more clarity here.

Rajiv Poddar: Thank you for the question. So, the geopolitical scenario has gone on for longer than expected in Europe. I mean, there is no visible end or way out. So, that is one. Also, a lot of it is dependent on the weather, how severe it is in Europe because of the geopolitical scenario, they may, if their weather is, you know, they have a severe winter, it may have a different impact on the overall financials of Europe, whereas if the winter is milder, it may safeguard some of the financial stress in Europe. So, those things do not give much confidence at the end user level. So, everybody is waiting and watching. So, that's why we cannot guide what is happening in the near future. The geopolitical scenario needs to, you know, really be played out before we can comment on volumes.

Siddhartha Bera: In the last quarter also, we have highlighted that there has been some channel destocking by dealers and distributors. So, on that perspective in the current quarter, you have seen further sort of destocking, and where are the channel levels, if you can broadly indicate as well?

Rajiv Poddar: So, we have seen further destocking. So, all these things are coming together making us unable to comment on the outlook for the guidance.

Siddhartha Bera: Lastly, sir, if you can comment on the price increase? If you see the ASPs, they have increased sharply by about 9% quarter-on-quarter. And what I recollect, last time you said there had been no significant price increase in the quarter. So, can you highlight what led to the sharp jump in the ASPs?

Rajiv Poddar: Yeah. You rightly pointed that out. So, there are three main factors that have contributed to this. One is that the overall product mix has been better. So, you know, over the period, we have been upgrading our equipment, and saying that we are moving to higher technology tires. So, that has contributed to the ASP. Also, the dollar movement, which has gone up sharply, has impacted the ASP, and the higher contribution from Northern America sales. So, these three factors have contributed to the ASP.

Moderator: Thank you. The next question is from the line of Jinesh Gandhi from Motilal Oswal Financial Services. Please go ahead.

Jinesh Gandhi: Just continuing on the ASP part, you indicated a higher contribution from North America. So, the higher risk in North America is just because of the higher share of OTR versus agri. So, is that the reason the ASPs are better there?

Rajiv Poddar: Yes, and the user larger diameter tire, contributes to a better product mix.

Jinesh Gandhi: Second question pertains to the European market. So, what percentage of EU Europe demand is met through local production? And based on that, do we expect some further market share again, because of the cost inflation seen in Europe?

Rajiv Poddar: No, we don't have those numbers with us.

Jinesh Gandhi: Lastly, can you talk about how RM cost increased this quarter? And based on the current prices, what kind of savings do we expect on RM, logistic cost, and freight cost?

Rajiv Poddar: So, both are softening. Raw material cost is also coming down, and freight rate is also coming down. So, in the coming quarter, you will see the impact, of course.

Jinesh Gandhi: In the second quarter, what was the impact of RM cost? You indicated there was an impact of RM cost. Can you share some of the magnitudes?

M.S. Bajaj: So, 200 basis points increased because of the dollar price, and in the coming quarters, we will see that it is softening. So, it should come down.

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

Ashutosh Tiwari: My question is that like you said in entry levels, the dealers are basically deferring the purchase. So, how are the inventory levels with dealers right now? And how that compares with normal inventory?

Rajiv Poddar: So, they are slowly, steadily de-stocking, and we are seeing that impact coming.

Ashutosh Tiwari: Okay, but how is the level generally? I think normal was three to four months. Is it in line with that right now?

Rajiv Poddar: So, currently, I mean, eventually, they will reduce it to two months as a target is to get there to two months.

Ashutosh Tiwari: Currently, they are around how much?

Rajiv Poddar: Maybe around three months.

Ashutosh Tiwari: This is across Europe and US? Or is this more like a Europe situation?

Rajiv Poddar: Europe and all over. Europe and U.S. both.

Ashutosh Tiwari: At retail level, are we already seeing the demand impact in Europe or is this just an expectation that demand will probably fall going ahead? So, I am saying that are we already seeing the demand impact at the retail level in Europe or is the expectation that is going ahead in the second half, demand will now taper off?

Rajiv Poddar: We can't comment on that, but we are seeing challenges that may create headwinds for us.

Ashutosh Tiwari: On the CAPEX side, we already have done Rs 900 crore CAPEX in the first half. So, how do we see CAPEX of full year and next year, if any guidance?

Rajiv Poddar: Around another Rs 300-400 crores will be spent.

Ashutosh Tiwari: Next year, any guidance?

M.S. Bajaj: Not yet.

Rajiv Poddar: Not yet. We will come back to you on that.

Moderator: Thank you. The next question is from the line of Pramod Amthe from Incred capital. Please go ahead.

Pramod Amthe: Thanks for this opportunity. Sir, wanted to know based on your long experience in handling these export markets, how different is the macro environment now per se? And basically, what tools do you feel you can use it from your end to handle this situation based on your past experience?

Rajiv Poddar: So, basically, if you go to see, these are unprecedented times. You know, we have not had a situation in a lot of years when there is a backdrop of a warlike scenario in Europe. So, that is having an impact. People have boycotted Russia and USSR, you know, so that impacts their ability to safeguard their people by buying gas etc.

So, those scenarios are unprecedented and out of our control, but what we are doing is, we are continuing to serve the market better. We are going, you know, from our ability to do the product mix to service them better, we are doing that. We will follow it up with our end users, with our distributors for promotion. So, we are not stopping anything.

Also, the brand building exercise that we had started, we are continuing all those things. So, you know, we are doing things that are under our control, and we are hoping that, I mean, we are quite hopeful that with these activities that we are doing, in the long term, we will sustain and outgrow the market. Even under these challenging times, you know, despite the challenges in Europe, we have outgrown the market.

Pramod Amthe: Are there any smaller players who are struggling that you feel will go out to the marketplace? How is the response of other competitors, especially the smaller ones, if there are?

Rajiv Poddar: We don't comment on our competitors. We have never done that. So we will stick to not commenting on them.

Pramod Amthe: The last question on inventory. As you said, they have gone up to three months versus a comfort of two months. Is it more because of the demand collapse and the absolute numbers which they are carrying are the same, but the base denominator of the demand has changed, and hence that two months, three months variation is happening? Or what is the or they overbooked or overbuild in that sense?

Rajiv Poddar: So, there are two things. Yes, you are right that the demand has slightly tapered off because of the geopolitical scenario. So, that is a contributor. Also, the shipping duration eased off because of the shipping availability. So, the shipping time is reduced. So, these two factors put together contribute towards getting them to have reduced their inventory.

Moderator: Thank you. The next question is from the line of Sonal Gupta from L&T Mutual Fund. Please go ahead.

Sonal Gupta: Thanks for taking my question. Sir, just going back to Siddhartha's question in the beginning, trying to understand, one, the ASP jump because, I mean, like, what you are saying that Europe, the higher contribution of North America, I mean, like, quarter-on-quarter there is no change. And even in the Agri, OTR mix, there is no change on a quarter-on-quarter basis. So, just trying to understand like there is some delayed impact of the price increases you took in Q1 or something of that sort?

Rajiv Poddar: No. So, there is no delayed impact on the pricing., As I said, one is the dollar movement, which happened in this quarter. You know, we were at about Rs 76 or so that has gone to about Rs 80-81. So, that has had an impact. And in the U.S. as we said is, you know, it is a higher contributor, and within the product mix we have been able to achieve product mix of a higher value, large diameter sales even within the Agri sector and within the OTR sector, we have been able to get sales of higher value diameter tires. So, the larger tires, more technology driven, and that had an impact on the product mix positively.

If you recollect my commentary from about a year back, we had said that we are actively pursuing to upgrade our equipment, which we have just said is over as to create a higher capacity for these larger tires and you see the impact of that.

Sonal Gupta: And just on the RM cost, right, like on a quarter-on-quarter basis, it's up almost $200 per ton. So, is that what is driving that?

Rajiv Poddar: No, the dollar, so the market, the raw material prices are softened, but when we convert it back from the dollar, the impact of the higher dollar has made it go up.

Sonal Gupta: No, sir, I am only looking at it in dollar terms. So, I am just trying to understand, I mean, what is driving that? Even in dollar terms, it seems to have gone up?

M.S. Bajaj: Now prices are going down. Last quarter because of the old inventory and material in transit, the price impact, raw material prices were almost stagnant or slightly plus. So, the impact is of the dollar increase, which is 200 basis points. So, now in the coming quarter you will soften the prices.

Sonal Gupta: Any visibility we have on the freight rates coming down, right? Because first half like you had mentioned earlier, you were tied to higher freight rates. So, do you know what sort of reduction we will see in the second half?

Rajiv Poddar: So, rates are continuously going down. The impact of that should start coming from December onwards.

Sonal Gupta: So, more in Q4 you say?

Rajiv Poddar: Yes, if you heard my commentary during my speech, I said that the raw material and the lower logistic cost should start kicking in from early Q4.

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

Chirag Shah: Thanks for the opportunity. Sir, I have three questions actually. Sir, one on the Fx side, if you can help us understand the Forex gain that we have realized, you know, realized Forex gain in a rising, in a depreciating INR scenario, if we have hedges, the gain should have been lower, right? So, how does this work on a net basis we have a higher realization and lower unrealized losses?

M.S. Bajaj: U.S. dollar we are not hedging. We are hedging only Euro. U.S. dollar we are keeping open for our raw material payment and machinery purchases.

Rajiv Poddar: Because there is a natural hedge there. So, we leave that open, and the balance we procure on the spot. Thereby, it is impacted again.

Chirag Shah: So, sir, how to look at this Rs 102 crores of gain that we have seen and which have been going up? How should we look at this number? How should we think about this number going ahead?

Rajiv Poddar: So, our hedge rates, we have given you our average hedges, but for Euro is at Rs 85. Going forward, we can't comment on what the euro and dollar will go to. We can tell you what we are hedging it.

Chirag Shah: So, our hedge rate, so when I say Rs 85, is it safe to assume for the next 12 months it is in this range, Rs 85 plus minus Rs. 2?

Rajiv Poddar: For this financial year, it is Rs 85. The next 12 months, I don't have the number, but it is in that range.

Chirag Shah: It is in that range. This is helpful, sir. The second question was, in general, if you look at your commentary, your guidance on volume, and the way you have indicated it is very worrisome, but in your commentary, it doesn't appear to be that worrisome. So, why such a big conservatism in your volume guidance? One. Why am I highlighting is because if there are cost pressures coming up in say Europe, for example, you have a natural advantage of a low-cost manufacturing base, and you can use that lever to gain volume/market share without impacting your profitability significantly.

Rajiv Poddar: So, we are seeing, I mean, as I mentioned this, we are seeing volatility in the marketplace. We don't know how the geopolitical scenario will play out. So, those things are worrisome. It is not that there are cost pressures on those manufacturers there, and we can use. It is, you know, today, we don't know how they, and the backdrop of war, how the scenario will play out. What happens? Who does what? So, those things are what are at a macro level can have a big impact. As I mentioned, even though the winter is severe, then it will have a financial implications for all the countries there. That may result in having lower, you know, a higher burden on the people with taxations or what. So, we don't know. So, those are the issues that are creating a worrisome factor. It is not that there is cost pressure only on the local manufacturer, but also on the end users, you know, there will be a cost implication for everybody.

Chirag Shah: But if you can help us understand one small thing, that versus a European plant that manufactures in Europe and sells in Europe, and someone like Balkrishna who manufactures in India, the cost advantage would have gone up by how much? Is it possible, it would have gone up by 5, 7 percentage points?

Rajiv Poddar: I can't give you the breakup of how much we have got advantage of because those we can't disclose those.

Chirag Shah: No, sir, relatively. Relatively versus what it was before this war situation.

Rajiv Poddar: I will tell you. Let me tell you one thing. If you look at the numbers, if you see, hear my commentary, I said that despite these challenges in the last quarter, our performance registered a sales volume of 78,000 tons, which is more than the market pace, which is more than what the people are doing there. So, that itself indicates that we are growing and taking market share more than the market pace is growing. So, that is an indication that we are already taking a market share.

Chirag Shah: Sir, last thing, this shift towards bigger tires that you indicated, the driver of your ASP in the quarter, one of the reasons, is this the new base? Because some of the efforts you have been putting in over the last 1,- 1.5 year have started playing out. So, can we assume that the kind of ASP or the mix that you have seen in the quarter can stay as a base or are there some specific orders that you won because the bigger tires were sold in larger quantity?

Rajiv Poddar: No. So, firstly, the product mix can change depending on the order scenario at that particular time. We don't have control over that. We now can do a higher capacity of the higher, larger diameter tires, which can improve my product mix. But if the order comes in the other one, you know, I don't use this as a base. I have only demonstrated that over the last 1, 1.5-year, whatever investment we have done towards creating this capacity has played out. Now if the product mix, order product continue to be this, I can continue to service in this category. If the product mix changes, we can continue to serve better to the other one. So, we are here to demonstrate that we can manufacture whatever the end user needs. Those are under my control. And we can do that, but I can't tell you whether this will be a based or not. That I cannot comment on because markets are not, you know, the demand is controlled by the end user.

Chirag Shah: Yeah, but at least for the next 3, 6 months, can we assume that the order book or the indication you have is for better utilization of this bigger tire facility?

Rajiv Poddar: No, I cannot comment on the future, because we are uncertain of what will happen. We can comment on what we are doing. We are doing all the things we have been telling you all about, and some of you are seeing the benefits of that, but we cannot comment on the market outlook, because we see a lot of volatility due to uncertainty in the geopolitical scenario.

Moderator: Thank you. The next question is from the line of Basudeb Banerjee from ICICI Securities. Please go ahead.

Basudeb Banerjee: Sir, just continuing on the same topic as Chirag was discussing, just trying to understand from a different perspective that as you said such a good volume in such a scenario where the peak of the geopolitical tensions was there, in fact, some softening in the geopolitical situation, the news coming. Also, the power cost and all other adversities were at their peak in such a situation where inventory restocking happened, such good volumes, record gross profit per kg, record ASP, all good things you delivered. In such a backdrop incrementally, you are taking the decision of removing guidance just because of a temporary volatility and uncertainty.

Rajiv Poddar: Absolutely.

Basudeb Banerjee: Can one look at from a perspective that too much guidance related expectation, if you don't meet too much pessimism, to avoid that, you are taking a clean slate, or you are genuinely concerned about incremental demand damage, that will be great, sir, if you can explain?

Rajiv Poddar: Firstly, thank you, sir, for summing it up very well for me. Thank you for that. So, I think there are, it's a mix of both. There is a genuine concern because we don't know how the geo political scenario will play out in Europe. We are uncertain of that and, you know, against that backdrop it is very difficult to comment on a number because, you know, we don't want to misguide people either upward or downward and being a conservative approach, we have always out beaten our number.

So, you know, it's a mix of both, but it's under current circumstances, it is too difficult to put any number because we don't know tomorrow you will wake up and what the political scenario will play out over there. So, under that backdrop, it is extremely volatile to give a number, but so, yes, you are absolutely right. It's a mix of both. There is a genuine concern, and there is also trying to use a clean slate so that we don't miscommunicate or misguide the market as to where the number will be.

Basudeb Banerjee: Second question, sir, again, on similar lines that record ASP sustainability is the function of multiple things. A few of them are beyond your control also.

Rajiv Poddar: Yes.

Basudeb Banerjee: If I look at gross profit per kg, which is above Rs. 180, another record level, which is largely a thing you can control through product mix and cost management where we are almost at the higher end of the raw material basket. So, any comment about sustainability or further improvement scope of gross profit per kg?

Rajiv Poddar: On the ASP, what we have said is we may not be able to sustain these numbers because if the shipping costs start going down, we may have to pass it on to the end users, so which we see there is a lot of multiple things that have been built into that. Also, if the dollar softens, that will impact the ASP because these are things which are, you know, the dollar movement etc., have factored into the upward trend when the dollar and it's at its peak today. If the dollar softens, we may have to soften that as well.

Regarding the gross margin, as I said, , we are estimating some raw material correction, which has already come in, and the logistic costs have started to go down. So, this should help us in our margins, and we have seen the benefit of that to start kicking in from the Q4 of this year, Q4 financial year.

Basudeb Banerjee: Sir, in the presentation there is some comment about Waluj plant CAPEX plan. So, if you can explain that?

Rajiv Poddar: If you go back, when we had taken up the idea of setting up a Greenfield project, we had said that the Aurangabad or the Waluj plant, which is our oldest plant, and the machinery, the building, etc., is becoming redundant, we had decided to make a new Greenfield project which was supposed to replace the old plant. When that new plant was commissioned, the business outlook was very strong and positive. So, we had said that we will continue both to cater to the demand as opposed to shutdown capacity which you can yet produce. Now we have and for doing that, we were going to spend roughly, the Board had approved approximately Rs. 350 crore for modernization of the whole plant.

Now under the current circumstances, we believe that rather than spending the money there, it may be wiser to spend it in the newer site where we have space to create a new Brownfield and add this capacity over there so that in the long term, both the plants are new and also under one location. So, your cost on economies of scale should kick in in that one plant as opposed to running two plants. So, this Rs 350 crore, which you will spend in the old plant for modernization will be used in the new location and create similar capacity. So, at the end of the day, in the second half of next year onwards, as I had mentioned, my capacity will go back to 360,000 with 55,000 coming at a single location at Aurangabad as opposed to having two plants.

Basudeb Banerjee: The older plant machinery, those things will be?

Rajiv Poddar: Some of them will be shifted, and the rest we will see what to do. We have not yet taken a call on the old plant and land what to do.

Basudeb Banerjee: 360,000 will remain with a modernized plant rather than using old one plant?

Rajiv Poddar: Yes, , absolutely correct. Temporarily, our capacity will go down to 335000 ton for the next six months and in that much time, the new plant will be ready and shifting should happen, and it should go back to 360,000.

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

Nishit: This is Nishit from Axis Capital. Sir, I have two follow-ups. One is still trying to understand the ASP issue. There are two points here. One, reason we don't hedge our dollar INR is that we have a natural hedge through RM imports in dollar terms.

Rajiv Poddar: Correct.

Nishit: Is it fair to assume that whatever higher realization we get because of a dollar appreciation versus INR, the similar impact we will have on RM cost per kg, so it will not be incrementally negative or positive for the gross profit? Because in this quarter we have seen a good Rs. 21, Rs. 22 increase in RM cost per kg. Is this the right understanding?

Rajiv Poddar: Absolutely correct.

Nishit: Or should we understand it differently?

Rajiv Poddar: Correct.

Nishit: , This dollar appreciation part is not impacting the EBITDA or the gross profit per kg right?

Rajiv Poddar: Yes.

Nishit: The second part is just wanting to understand how our Carbon Black plant is ramping up? And has the contribution of Carbon Black to our total revenues increased over the last one year which is also aiding ASPs?

Rajiv Poddar: Yeah. So, our Carbon Black sales is approximately 5% of our turnover for the last quarter which used to be about 3% but has now gone to 5%.

Nishit: Not that bigger change?

Rajiv Poddar: No.

Nishit: Because I was still understanding last year same quarter, your ASP was Rs 286 per kg. This time it's around Rs. 356. Our Euro INR rate has broadly remained stable. So there may be some benefit from a dollar INR, but it has got offset from RM cost per kg. Apart from that, is mix a very, very big impact that is benefiting our ASPs?

Rajiv Poddar: Yes.

Nishit: Or it's a relatively smaller part within the overall scheme of things?

Rajiv Poddar: No, it's a good contribution.

Nishit: Now going ahead, ASPs will moderate a bit because of freight cost, whatever special hikes you had got from your customer, that will get removed from the ASPs as well, right?

Rajiv Poddar: Absolutely. freight costs should also happen. The dollar movements will also contribute if it goes down. So, that will also soften the ASP. So, these two factors will affect our ASP.

Nishit: Sir, the last question is on the CAPEX and the debt levels. I can see that your net debt levels are closer to Rs 1,000 crores. We were almost net debt free. So, just wanted to understand what CAPEX you are looking for this year and next year? And is there an abnormal increase in working capital because of which debt levels have gone up? Or is it more of a normalization that has happened?

Rajiv Poddar: The working capital had gone up because the turnover had increased, and also the working cycle had gone up because of the extended freight rates, and freight shipping duration. So, that was impacting. So, that should now start normalizing as the schedule start reducing. The shipping time reduces. So, that should start normalizing.

The working capital, the long-term borrowing that we had done was towards project, and as we said that we have about Rs 300- 400 crore project left for this year and the balance for next year and of similar level. And that is the CAPEX that was already planned and approved. So there is no new CAPEX that we are envisaging for the moment.

Nishit: Sir, In Europe, the kind of uncertainty you are seeing, is it impacting more retail demand on the Agri side or is it also on the OHT segment? Why I was asking this is, if I look at one of your larger peers Michelin, they reported a couple of weeks back, and they are still talking about Agri market to be flattish in demand, but we are being a little cautious. So, just wanted to understand is it that Agri is more under pressure or you are seeing OHT also, OHT, basically OTR tires also getting impacted in Europe?

Rajiv Poddar: We see both, both being impacted.

Moderator: Thank you. The next question is from the line of Ankit Kanodia from Smart Sync Services. Please go ahead.

Ankit Kanodia: I would say an impressive set of volume and given the guidance we gave last quarter of the cautious market, I have two questions. One is, sir, if we go back and look at the past recessionary period, if you can share your experience, how do you see the OEM and replacement mix changing? Because of my limited understanding, I would assume that if Europe is going through a recession, probably, say, a farmer would be using a reused tire more, right? So, maybe the replacement market would do better than the OEM. So, is it fair to assume that the replacement mix would increase during this period?

Rajiv Poddar: Yeah. I mean, we are here to cater to both the replacement and OE. We can cater to both. We have already got a good name in the OE sector. So, that is all working. Also on the replacement side, the brand promotions and all that we have been doing, has had an impact, and we have been able to create a brand name for us. So, if the replacement cycle works, we are already there. Today roughly 70% of our channel is the replacement segment. So, we are geared up to cater to that if it comes to it.

Ankit Kanodia: Regarding market share, again, during recessionary period, I would assume that even though absolute volumes may not increase or may probably be flattish, it would be a good time for you to have market share gain if you look at history again, how it has happened in the past slow down period?

Rajiv Poddar: Yeah. That is what we are working towards to increase our market gain, I mean, to gain more market in these times. So that is what we are working towards.

Ankit Kanodia: My second question was related to CAPEX. So, regarding our Waluj plant, we have been back and forth. Earlier we wanted to do the Greenfield expansion, and there was a very good demand. So, we stopped that, and now that we have a lot of time. So, the only thing I see over here is that it would take about a year or maybe 12 months to get that complete capacity up and running. So, the only risk could be if the market recovers or it doesn't fall the way we are anticipating because in Q1 also, we mentioned that market, we are very cautious, and we have also refrained from now giving guidance. But what if the market goes up and we get the demand back? So, do you think that that is a risk maybe in Q4 and Q1 of the next year?

Rajiv Poddar: Yes, that is the short-term risk, but in the long term, it will have a better impact. And you know, if you don't do these activities when you are not, you know, when there is a volume, there is no volume pressure, then you can never do it. But if you see in the long term, this will have a much better and positive outlook on the cost and cost structure for the Waluj plant. So, at some stage you have to do it. So, you know, you can't do these when there is pressure from the market to supply more. So, you can only take these challenges and do it when there is no challenge from the market, there is no pressure from the market. So, we don't foresee big pressure from the market in the next two quarters, and that's when we decided to go ahead, and so in the long term you will see a benefit.

Moderator: Thank you. The next question is from the line of Abhishek Jain from Dolat Capital. Please go ahead.

Abhishek Jain: Thanks for the opportunity, sir. Sir, how was the logistic cost per ton in the second quarter? And how is the outlook aid for the third quarter?

Rajiv Poddar: Logistic cost is marginally going down.

Abhishek Jain: So, how much was logistic cost per ton in second quarter, sir?

Rajiv Poddar: It was, I mean, if you go to see, the logistic cost per se is starting to go down. However, because of the marginal higher contribution from U.S., the per ton sales are higher, per ton cost is higher. But we see the cost has decreased quite a lot. So, you will see the impacts of those coming down in the next few quarters. Starting from this quarter and the main benefit will start coming from early next quarter.

Abhishek Jain: Can we expect a 25% to 30% fall in the logistic cost in the coming quarter?

Rajiv Poddar: We are hopeful.

Abhishek Jain: Sir, what was the current RM basket cycle like synthetic rubber, rubber and Carbon Black in Q2 second quarter? And what was the impact of the fall in the RM prices in the third quarter and fourth quarter earnings or margins?

M.S. Bajaj: Third quarter you will see, but the major impact will come in the fourth quarter only. Third quarter, there will be softening of the prices because of the inventory. It will be a mix of both, but in the fourth quarter you will see the real impact.

Abhishek Jain: What was the price, sir, for the natural rubber in the second quarter, synthetic rubber and the steel wire?

M.S. Bajaj: Second quarter was natural rubber was Rs 150, but this quarter it was Rs157. And synthetic rubber was Rs 165 versus Rs 178 for this quarter. But the next quarter, we see rubber, natural number Rs 157 to Rs 150, and synthetic rubber Rs 178 to Rs 145, Rs 150.

Moderator: Thank you. The next question is from the line of Garvit Goyal from Nvest Research. Please go ahead.

Garvit Goyal: Sir, in Quarter 2 Financial Year 23 itself, 49%, the complete revenue came from Europe, and 20% came from the America. And geopolitical problems going on, like the energy crisis in Europe, and the recession in U.S., it will be very useful if you could share the industry data regarding export of tire to the Europe and the U.S. market in quarter two Financial Year '23 means how much export impacted because of all the scenario at the industry level?

Rajiv Poddar: We don't have that number, ma'am.

Moderator: Thank you. The next question is from the line of Disha Sheth from Anvil. Please go ahead.

Disha Sheth: Sir, wanted to check that going forward since the dollar rate and the freight rate is coming down, have you taken any price decrease in the near future on the new orders?

Rajiv Poddar: Not at this moment. Not at this moment.

Disha Sheth: And sir, I just missed the answer when you said that we had increased the ASP in this quarter because of three reasons. What was that?

Rajiv Poddar: The dollar movement upwards, higher contribution of higher value large diameter tires, and higher contribution from U.S. sales.

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

Chirag Shah: Sir, thanks for the opportunity again. Sir, again, hopping back on the earlier question that given the cost advantage increase the cost advantage that we may have versus some of the local manufacturers over there, do we intend to use that to gain volume or are you looking to maintain margin that is for next one or two quarters? How do you look at it? Given the answer you indicated,would the primary focus be on utilization of assets or would it be per unit metric? How would you look at it?

Rajiv Poddar: Historically, we have always shown that we never compromise on our margins. That said, we will continue that, but we will draw a balance between these factors of utilizing the available capacity and maintaining margin. So, we will strive towards what is the best, you know, it will be on an individual basis. It's very difficult to give a generic statement for that.

Chirag Shah: And sir, one last thing is, at a different point in time, if you can indicate what kind of SKU mix has changed for you in terms of bigger tires, you know, either in terms of proportion to your capacity or in some form, it would be helpful. You have done many things over the last few years to improve your capabilities. If you can get a slightly broader breakup of that, it would be helpful to understand the changes that you have done internally.

Rajiv Poddar: We can connect offline to share those numbers.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to the management for their closing remarks.

Rajiv Poddar: Thank you, everyone, for coming time out to join us. See you next quarter.

Moderator: Thank you. Ladies and gentlemen, on behalf of PhillipCapital (India) Private Limited, that concludes this conference call. We thank you for joining us, and you may now disconnect your lines. Thank you.