“Nelcast Limited's Conference Call”

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MANAGEMENT: MR. P. DEEPAK – MANAGING DIRECTOR, NELCAST LIMITED.

Interviewer: So, if I recall right, we were at that time looking to focus on exports and enhance our value addition as a result. Where are we in that? I am sorry, I have not really followed the company too closely. I just want some understanding of how our plans panned out.

P. Deepak: So, if you look at it right, just we have got it graphed out. So, I think when we met, we were probably looking back at FY19 numbers perhaps. So, we have done about Rs. 90 crores or so export in FY19. So, FY22, what we just reported are Rs. 220 crores. So, that strategy whatever we were talking about its playing out. And we have got good amount of new product launches happening this year FY23.

So, we have got some new products that we have already been awarded, product samples have been made, testing, in most cases its completed, it's just waiting for the launch date to kick in. So, one of those products is actually our first entry into the light vehicle segment in the North American market so that's about 20 kilo component that we are going to be supplying to our customer, American Axle who is going to make the axle. And this is going to go on the Chevy Colorado series of trucks, which also I think includes the GMC Sierra trucks as well. So, we are going to be supplying on all of those trucks, that rear differential carrier is going to be supplied by us. And that official start of production at the GM facility is in January so several months prior to that we will be starting our production and our ramp up in the next few months.

Interviewer: And how does this work, I mean the base business that sustains at that level, depending on how the vehicle is accepted in the market. And then over and above that you have to build new business, new products or is it that existing products itself add to volumes?

P. Deepak: So, it's been a bit of both, if you look at us a little more historically, right. This particular business is an eight year of business. So, this business, whatever we have been contracted with has a lifespan of eight years. After eight years this will get phased out. The next generation will come in and take its place. So, we have got opportunity to win that next generation probably two years before that, six years from now or so, right that's when that, they will start sourcing decisions on that one. So, that's in this particular case.

In other cases, what we have seen is a mix of two things happen, in terms of how this growth has happened and how have we gone from that Rs. 90 crore to Rs. 220 crore kind of a number. The two things that have impacted this is, one, gaining share of business within existing customers. So, in lot of cases, when we were stating business for the first time with the customer, they will give us a product. But they don't want to rely on a new supplier who they don't know very well for that product. So, they gave us in couple of actually both with Detroit and Dana who are, Detroit who are our big customers today. They gave us 30% business of one product. And they said here, this is your business. And as we proved ourselves capable of quality and delivery, they have kept increasing that. So, the product that we launched in Dana U.S with, in 2016, we launched it at 30% share of business as of now we have 100% share of business. So, we are the sole supplier for that.

Similarly with Detroit Diesel in 2018, 2019, I think it was 2019, early 2019 we launched this product. We were awarded a 30% share of business but when we launched whatever this thing we started off with 10%, 15%, 20% whatever but we were contracted to be at 30%. We are currently at 50% and shortly moving to 70%. They just approved us to put us at 70%. So, this share of business increased. So, when all the business started off, it was a small piece of the pie, saying we got our foot in the door, got a small portion of even within a certain product. The existing supplier was already supplying and we just got a small portion and just as a kind of a tryout. And then we have basically displaced that existing supplier.

So, with Dana, then the second products that they sourced from us, they sourced us at 80% share of business, kept 20% domestic, those 80s have now had become 100s, few years ago. So, we have been and now when they are sourcing us new on new products, they are sourcing us directly at a 100. They feel that that perceived risk, whatever that they had, they were concerned about earlier, is --

Interviewer: Because they have tested you and they have seen --

P. Deepak: Yeah.

Interviewer: And I recall that at that time, our aim was to reach 30% of volumes to come from exports.

P. Deepak: Revenue, yeah.

Interviewer: Yeah, how are we placed on that?

P. Deepak: So, we have now gotten up to 24% for the last financial year.

Interviewer: And is there an incremental target? Like, are we like raising that target going forward?

P. Deepak: So, I think we have tried to get away now from percentage, but we are trying to move more towards in terms of absolute number. So, if you look at last year, right, Rs. 220 crores is roughly about a Rs. 55 crore per quarter kind of a number is what we are, we believe with these launches, what we have got going on and new products, we should be able to get to about Rs. 90 crore to Rs. 100 crore of quarter kind of an export by end of this year.

Interviewer: So, about a Rs. 400 crore --

P. Deepak: Run rate.

Interviewer: Run rate, yeah. So, I mean, it may be towards the end of the year but whatever.

P. Deepak: So, I think that that's something that we see very much within the realm of possibility.

Interviewer: And that is because you have an order book which suggests this or? You have an order book.

P. Deepak: I would say probably, when we talk about Rs. 100 crore, what I can confidently say Rs. 85 crore is already in the bag as on order book.

Interviewer: Okay, thank you so much. Rs. 85 crore is in the bag, okay.

P. Deepak: Product development; everything is done. We actually recently got a new product order as well, which goes on GM's electric delivery van. So, this is, again, very short notice kind of a thing, they just gave us the order recently, and it goes into production by January itself. And this is, I think FedEx has ordered some several thousand vans, they have already sold out their first year of production, I mean they haven't started production yet, right they have already sold out. They start production in January, they have already sold out their first phase of production in terms of volumes. And then they are going to launch. So, I think this is a 600 cubic inch storage delivery vans. They have got a 400 cubic feet delivery vans that they are going to launch in 2024, which they believe will have higher volumes. So, that we are already in the sourcing discussion for that, we believe that order is imminent, we will get, we will likely win that order for certain product.

So, with these in the pipeline and then every once in a while we get sudden opportunity that comes which seems to be a lot more short term kind of a thing. We have got some business we are working with Meritor in North America. And we believe that that we will win that business as well. And that potentially they want some products we are getting into production by the end of the year as well. So, that's why we feel like getting to that Rs. 90 crore to Rs. 100 crore per quarter kind of thing is very much feasible.

Interviewer: So, FY24 will be the year where we will probably do Rs. 400 crore kind of a per year export?

P. Deepak: That's what it looks like at this moment, yes.

Interviewer: And, of course, raw material cost has gone up. And at the time that we met, I think we were doing Rs. 125 to Rs. 130 a kg realization, on exports particularly. And that today stands where?

P. Deepak: So, whatever raw material increase are there, have been passed through. And freight also, a big chunk of the freight increase also has been passed through. Some chunk of the freight increase is still under some discussion, negotiation going on. Some chunk is still in that bucket, but majority whatever I think chunk of it has already been passed through. So, I think there is pretty much that addition that's there right so export is what now at Rs. 180, Rs. 175 to Rs. 180.

Interviewer: Yeah, Rs. 175 to Rs. 180.

Management: Now the total average itself is Rs. 125.

Interviewer: Rs. 125.

Management: Yeah, so that time maybe it was about Rs. 90 --

Interviewer: Overall average, yeah, so okay got it.

P. Deepak: So, these raw materials we have been able to pass it through into the market, whatever that inflation has been there that's been passed on to the customers. Only thing is of course, it took a little bit of a hit on last year's P&L because of the lag. So, what the mechanism is we take this quarter's average raw material price and that is fixed as your base for the next quarter. So, unfortunately, what happened in the last year is this delta average of this quarter and next quarter was so far apart, that we were being passing through this number, and we were kind of paying this number. And then the next quarter, we thought, okay if it's stable, it would be good, then unfortunately, it went up again. And it was so substantial in the last year that it's definitely taken hit into our P&L.

Now, hopefully, we actually started to see Q4 in February, things were starting to stabilize. So, a mild decline in raw material prices. And then suddenly, our friend Putin decided to go into Ukraine, and that just made things haywire again, in March. Of course, in the last couple of weeks, with the announcements from the Finance Ministry coming through we are starting to see some decline in prices, we don't know what exactly it will be, I think everybody is still feeling out the market to see where it will end up. But certainly, it's going to decline.

And hopefully, this lag effect that you suffer with when it increases is something is, again a lag effect when it comes down. And we are seeing strong demand throughout and so which is honestly, the reason why we have been able to pass through the raw material prices, without too much difficulty.

Interviewer: Now, the other thing that one hears is that, and more so off late after April, May, and the announcements from U.S. Fed, is that U.S. market is starting to weaken. And of course we are a drop in the ocean and there is a very big market to take. You can keep taking the market, despite the market actually coming down and keep growing. How do we look at this, that if the market stagnates or comes down, does it impact us in volume terms or no?

P. Deepak: So, I think there is, I can play the silver lining of everything --. I will play the silver lining first and then I tell you what I think is the situation, right. The silver lining is, when volumes are going down, when all of that, all the guys in purchasing are under much more pressure to show cost savings. So, their best opportunity to show cost saving is –

Interviewer: Is to come to India.

P. Deepak: To be able to be resource products from our competitors to us, which I believe we will be delivering the cost benefit to them. The second part of it is the other way around, when the market is increasing and the domestic guys are unable to ramp up and supply to those volumes. There is another opportunity there when, for us to be able to come in because of poor service.

And it's not easy to go from Rs. 100 to Rs. 150, just like that, which can happen in the market. But again, so we have seen both of these opportunities. We have seen both of these opportunities play out in the last few years. So, I just wanted to highlight what a silver lining is typically in spite of ups and downs in the market we have been able to grow.

Now, but I will tell you what I think about the market and why I think so. If you look at, break it into two sections, right, one is classic, if you look at classic, there is a chunk of what we do that goes into that classic market. They have such a huge order backlog, up until from September of last year, they have been throttling order intake based on production slots, based on availability of semiconductors and other supply chain issues that they have had plus their order backlog is so high even if there were no semiconductor issues, they still need a long period, almost a year to kind of work through that backlog.

So, there is this backlog. So, unless there is an incredible amount of cancellations which I believe is very unlikely. I don't see that, even if there is some slowdown in the market, at least this segment with the amount of backlog of order intake that they have received in these last couple of years I think the segment will do well, at least for the next two years, they have got such a huge order backlog that's there.

The other part is on the light vehicle segment which we are just entering, obviously, it's new for us. So, we are going to be supplying components that will go on the new Ford Super Duty, starting January. So, this component again is an axle differential carrier. The axle is assembled at Dana at their plant in Fort Wayne, Indiana. And they supply it to Ford's Kentucky plant, they assemble it there.

I went to a dealership in Kentucky, not that far away from the Ford plant that actually manufactures this. I told the guy I want to see one of these vehicles. So, when I wanted to go see that vehicle, he said sorry, I don't have a model on the floor. I said do you have one in the lot, I can go see. He said no, I don't. I said okay, what if I want to place an order for a vehicle? He says I can't even take an order today because Ford has not released production slots because, this thing. So, I said what about the guys who are getting orders now, when are they getting their deliveries now when did they place? He said 9 to 11 months ago, whoever is getting it, right. So, there is a backlog of orders even for that.

And let's keep in mind the Ford Super Duty is the most profitable product that Ford sells, right. If they have such a backlog for this, what it means is, if they got semiconductors, they would prioritize this manufacturing over anything else. So, in spite of that, this is the kind of backlog he has.

I asked him about a couple other vehicles, he said, I can't place orders for those; I know which was the F-150 Lightning which is the electric F-150. He said, on the day the vehicle launched, if you purchase, if you have placed the order, I would have taken it. The next day onwards this is locked, they just got such a backlog already on one day they received that they basically Ford is not letting the dealer place an order for a vehicle.

Now I said what can you give me? He said, I can give you a Ford Edge, I can give you a Ford Explorer. I said, okay, when can you give me the Explorer if I placed an order? The guy says six to eight months. So, this is the kind of situation.

And so when, there is talk about consumption, I mean, we saw target numbers come through and suddenly there was this fear that consumption in the U.S. is coming down. We are hearing all these signs. But when we hear about order backlogs of this extent, sure if there are layoffs, maybe there will be a few cancellations, some cancellation. We talk about a backlog with a year, really I don't see, at least in the short to medium term, I don't really see in the next year or two years that there will really be a substantial impact or demand collapse that will happen to that extent.

And today, the labor shortage is such that if because of slowdown, whatever, if somebody loses a job, they are able to get the job elsewhere. There, every single store, whether it was a Target, restaurant, hotel, warehouse, every single place of business, I went to had 'Help Wanted' sign, 'We are Hiring' sign whatever it is, right there is a real shortage of workforce. And some of which we have benefited from because our customers who were dual sourced on some of the parts have converted to single source because they have told the other day, listen, we are going to take this off your plate, you please perform better on the ones that are still on your plate, because you are not able to meet what you have this thing.

So, this situation, I don't know how it's going to play out. But with the amount of order backlogs is there, I feel reasonably comfortable that at least, okay, next year or two years, at least for the calendar year '23 should remain fairly strong. I mean, how severely is the Fed going to react? And what kind of impact is that going to have? I don't know.

And if we look at, again, the U.S. market, freight costs have gone up quite substantially also, domestically, right, trucking cost I am talking about. So, that is also driving more in terms of classic demands and things like that. So, between trucks, whether we are talking about heavy duty trucks, I think there seems to be demand. I think on the light trucks also, the demand seems to be there with all these backlog. Now, it's a question of, setting the supply chain in order and whittling away through this backlog.

Interviewer: And we have added to capacity.

P. Deepak: So, the last addition to capacity was in 2020, when we have added that bigger line, right. So, that bigger line is now giving us capability to do parts which earlier did not have the capability.

Interviewer: So, we were doing 95,000 tonnes earlier, in say 2018, maybe '19. Now, how much are we doing? And what is the capacity?

P. Deepak: So, last year, we actually did only 72,000 tonnes, for obvious reasons. I think this year, that 95 number we will be exceeding. Our capacity is at 160,000. We believe we should be able to achieve about 80% odd of that capacity, so about 125, 130, not in the current year but we think within the next year or two, we should have the same depending on market recovery, I think, exports seem to be doing quite strong and that will also aid in that.

Interviewer: And these will be larger products, more complex from the new facility.

P. Deepak: Yeah.

Interviewer: And the new facility is what 50,000 tonnes?

P. Deepak: 60,000.

Interviewer: 60,000 tonnes.

P. Deepak: Yeah, 60 in total, there are two lines in that, one is a smaller line, producing smaller parts at a kind of higher volume, higher speed kind of thing, that is 18,000 tonnes. 42,000 tonnes is the bigger line. And that bigger line actually is capable of going up to 72,000 tonnes. And actually the line itself is designed and running at, to be running at 72,000 tonnes. The furnaces that we have added, we have added only one set of furnaces, we just have to add one more set of furnaces and we can achieve it. It's a fairly more, slightly more modest investment. It's not a substantial investment for us to add another 30,000 over that.

Interviewer: Okay. And so that means that from 70 to whatever 140, 150 is of the journey in the next two, three years, maybe.

P. Deepak: So, I think in the next couple of years, yeah 70 to maybe about 120, 130 something like that is what we what we potentially see it at.

Interviewer: And what is the kind of EBITDA per tonnes that we make?

P. Deepak: So, EBITDA per tonnes, so last year, if I look at the whole average, it was about Rs. 9, right. It was Rs. 9 per kg. So, Rs. 9,000 per tonnes was the EBITDA last year. Unfortunately, as I mentioned, it was driven down by two things. The two things that drove down this number, were one was you know, some of these startup issues that are there in the new plant in the new line because we had just commissioned it. So, getting new products approved. So, we have got to make samples of multiple this thing, initial, whatever teething problems that are there when you make samples. And these are all products we have never made before, right. We never had the capacity to make a product that's 1.8 meters long. We never had the capacity to make a product that was 380 kgs heavy. So, these are all new. So, that there were some learning curves that we did go through last year that was one. The second was this lag effect that I told you about passed through of raw material prices. So, that brought us down to that Rs. 9 kind of a mark.

Interviewer: And what were we doing earlier, say prior to COVID, where had we peaked?

P. Deepak: So, I think about Rs. 10 or so I think we were at, right.

Management: Yeah, in '18, '19 it was Rs. 11.

Interviewer: Rs. 11, so 11 is where we peaked, right. And in '18, '19 would have been unusual year, I assume, you know, not a --

Management: Volume wise we touched up about 92,000 tonnes**.**

Interviewer: So, for that reason, we were at, okay.

P. Deepak: So, right now, what we see this year, we think we can get it to a level that's probably around 12. I think that's the level we can get, in fact if you look at Q4, I think Q4 was about 10.5 right.

Management: 10.48.

P. Deepak: 10.48, so Q4 was at about 10.48 or so. The main effect, again, is going to depend a little bit on this raw material price issue. But I think everything has been passed on right, there is this thing. And now, hopefully, with some drop in raw material prices, that's just started to happen, where everybody is still a little cautious in terms of trying to feel out the market, to figure out you know where this is going to end up. So, nobody is trying to commit too much and then have to correct, lose money in the wrong directions. So, everybody is being a little cautious in reducing the price of scrap. So, I think it will play out over the next couple of weeks and we will figure out where that new equilibrium is. But undoubtedly, there is a drop right.

Interviewer: And the falling market helps us?

P. Deepak: In raw material prices, yes.

Interviewer: Because of the lag, a lag in passing on your price to the, I mean, the reduction in your price to the customer. But there must also be a situation where you have contracted your raw material ahead.

P. Deepak: No, not really. So, see the raw material that we are buying, majority of it is most all of it actually is coming, steel scrap coming from traders. So, these are guys that buy from Hyundai, who buy from many other auto ancillaries, get them to their warehouses, bundle them and then so that's a certain value add that they are doing and then ship them to us. And we have also got certain requirements, we can't take any scrap, we would prefer scrap that has lower manganese, we don't want scrap with any chromium in it, we don't want scrap with any nickel in it, these type of, we have certain requirements so they will also they might also do some segregation activities or something like that, to do it.

So, it's almost a day-to-day market. So, we can do a few tactical things. So, Sivakumar may one day decide, I think the price is going to fall or something like that he will decide not to buy for a few days because we have inventory that we can hold for a few days. But suddenly, if he feels that, okay, I have got a great opportunity to really negotiate a better price with the supplier who can pick up 3000 tonnes in one go and we have got space to be able to store it and all of that. So, it's really a dynamic game that we are trying to do a little bit tactically, but the reality is it's a spot market. So, whatever price he was offered this morning, he will not be offered tomorrow, it maybe vary, it’s market driven.

Interviewer: And our machine parts were about 60% of our volumes, at that time, if I remember right. And of that majority was outsourced?

P. Deepak: Correct, still it’s the same, it’s probably closer to 65% to 70% right now, the percentage. Majority is outsourced, I will say probably 15% is done internally and the remaining 85% is outsourced.

Interviewer: Why don't we add capacities for that?

P. Deepak: So, two reasons, I think, one, we feel from a core competency standpoint, this is our core competency, we see a great amount of runway, I mean, if we look at, what it looks like, right now, in terms of this year, with, we believe that there is a significant amount of growth that's going to be possible in this year and next. I mean the kind of opportunities that we have in export, perhaps the next five years might look quite good, so one is as a core competence.

Second is also has an area of focus in terms of both management focus and also investment. So, for the kind of investment that we need to make so one, I think, for us to develop the kinds of capabilities that we need to really be at the level of some of our suppliers who we work with one of whom is Craftsman recently listed company, and then there is a couple of others that we work with. So, these for us, it will take us a few years to get to their technical capabilities, we will have to hire, we will purchase machines, this has happened to us few years ago, we purchased machines for a specific project, unfortunately, that was in 2008. And that particular project just collapsed in 2008. And so we were stuck with these machines, we don't have any other business for them.

In our molding lines, we have so many different products. If one business goes away, there is a whole bunch of other things we can occupy that space because it's very easy. So, if I had, in machining centers, if I had 200 machining centers, it's the same story. But when I start with one, so there is obviously some amount of initial pain, there is going to be some amount of capability building all of this that needs money as well as management focus.

So, we believe that that's better served focusing on what we know how to do, which is casting. And we think that there is a huge amount of potential that we can unlock in the next five years or so. And then at that point, we will have to look at what next, is this, what we want to do or do we want to look at other materials aluminum, steel, aluminum casting, steel casting, whatever else, maybe there are? Or really we will have to evaluate the market and what our opportunities are? And why we would take that opportunity? Are we taking that opportunity, as a counter cyclicality play towards our existing business? Are we taking that as something that we have already a huge customer base that we can leverage and grow very quickly and be able to do a better job? So, that's really a decision that we will have to arrive at some point and talk about at some point. But what we see in this near future seems to be quite exciting in terms of growth. And so that's where we want to keep our focus, and not take our eyes off that ball.

Interviewer: And who would be our key competitor, Kirloskar Ferrous?

P. Deepak: Kirloskar would be one of them. But maybe if you look at the scale of the business, what we do, maybe about 20% or 30% of that business only overlaps would overlap with Kirloskar. A good chunk of what we do and majority of the growth that we are seeing is coming, actually in ductile iron. Kirloskar doesn't do ductile iron, they do only gray iron.

Interviewer: What does the duct --?

P. Deepak: Ductile.

Interviewer: Ductile iron, okay.

P. Deepak: So, ductile iron or SG iron as it's called, basically, it's a slightly different process for manufacturing, it's the same metal, you melt it to a slightly higher temperature, there is certain alloying elements that are forbidden to use in ductile iron, which you can use in gray iron like, for example, chromium, and tin and a few other things. And phosphorus and sulfur are very dangerous for ductile iron. But ductile iron gives you a strength, that's about twice, double of what you get with gray iron. It's also more expensive.

You are adding, the way that you create this additional strength, you are actually adding some magnesium into it. And what the magnesium does is it changes the shape of the carbon in that microstructure. So, instead of carbon being there as kind of flakes, it’s there as spheres, and that gives it that additional strength.

Interviewer: They have pig iron, right. So, I assumed that must be one of the reasons why they don't do ductile iron.

P. Deepak: Right. So, pig iron use in ductile iron is generally much lower, we don't exceed 10% pig iron if we use it as a material within our ductile iron. I think they use something like 30% of their own pig iron into their gray iron. They also have a big chunk of what they do, and you know where their focus, is in engine block and cylinder head, which we don't do. So, the big focus for us, ductile iron, they don't do; the big focus for them, which is a block and head, they don't do. There is tractor housing piece that we both do. And there is some competition that may be there in that. Specifically, I think mainly the Tafe, Tafe is our biggest customer and they buy most of the heavy castings from us. Mahindra is their biggest customer they buy most of the heavy castings from them. So, there is really --

Interviewer: Different product lines --

P. Deepak: Slightly different --

Interviewer: And so who would be someone who you would say is similar?

P. Deepak: Maybe, Mahindra CIE, they might have something like that otherwise in most of the other cases we are competing with a lot of local players. So, when we supply to let's say, Tata Motors in Jamshedpur, there is a lot of local Jamshedpur foundries that have, supplying parts to Tata Motors in that Eastern region. We supply to, let's say we are supplying to Tafe, so Tafe would be, I think we are the largest, I think almost 40% of their heavy casting spend some comes towards to us. And then 60 is probably divided among three or four other players.

And then Ashok Leyland, if we take, we are supplying to them, they have their own captive foundry and they are buying from the Coimbatore or Kolhapur area, a lot of smaller players in that region.

But when I look at kind of bigger players, who we might compete with, and who I think are, capable, globally to be able to meet the requirements of a global player as well, handful, and I think Mahindra CIE would probably be the one that comes to mind, because they do entirely ductile iron. But in terms of size of their casting business to us, I think they would probably be, maybe somewhere about two-thirds of our size, of their casting business, or maybe even less than that. Yeah, I mean, if we do our capacity ramp up, they will probably be less than half, half our size if we were to look at what this year might turnout, if they choose their capacities well, and we use our capacity, because our capacity is higher than them for sure.

Interviewer: Okay. So, we are the largest in India.

P. Deepak: In ductile iron, yeah. And overall casting also between us, Kirloskar Ferrous is pretty much overall numbers in terms of casting is very similar. I think they might be marginally higher than us in terms of how the last financial year ended up. They would have probably done slightly more tonnage than us. Potentially, in a year or two, it will be, I think it could be different.

Interviewer: Yeah. And if I do a simple math 160,000 tonnes and 125 average realization, we could be somewhere close to Rs. 1,800 crores to Rs. 1,900 crores revenue.

P. Deepak: So, let's take about 80% of that Rs. 160,000 right.

Interviewer: I am saying that by then you will have added new capacity also. So, say three years, 160,000 tonnes odd capacity and so about Rs. 1,800 crores to Rs. 1,900 crores kind of revenues, right. And by then we will have, say Rs. 11 to Rs. 12 EBITDA per tonne.

P. Deepak: 12 plus.

Interviewer: 12 plus, right.

P. Deepak: We would like to in the next three, four years, we would like to get that to 15. But 12, we see this year that we should be able to push --

Interviewer: So, which means that I mean, we are moving into a different orbit in terms of profitability. I mean, we have not had this kind of a profitability in the past. And that's --

P. Deepak: We hope so, right I mean.

Interviewer: Touch wood, yeah.

P. Deepak: Touch wood, right I think that's, yes.

Interviewer: And that's a function of how we have, you know, what kind of products, what makes utilization all that and scale of course, scale obviously benefits, all that, okay. And what is our employee strength today?

P. Deepak: About 1200 to 1250.

Interviewer: And so if I was to just do again, a simple math, we would be somewhere close to Rs. 200 crore to Rs. 250 crore, EBITDA in the next two, three years.

P. Deepak: So if you were to take 160,000 and say, okay, let's call it Rs. 13, Rs. 14 whatever rupees a kg. If we call it Rs. 15, it becomes 240,000, little less than that, we have probably, yes, something about Rs. 200 something like that.

Interviewer: Rs. 200 plus crore kind of EBITDA. And debt on the balance sheet today is?

P. Deepak: Net debt is about Rs. 220 crores.

Interviewer: And will this remain here or we see this coming down over the years?

P. Deepak: So, what we see is, see because of revenue growth, we see working capital will get increased. But as we pay down our term debts, our term debts, I think it should remain relatively stable. I don't see it going up substantially. I also don't see it coming down substantially. It should be something in that range.

Interviewer: And what is our working capital cycle?

Management: 2.5 months networking capital cycle.

Interviewer: Networking, and it will remain in this range. And I mean despite exports becoming a larger proportion of revenues, this will remain in this range?

Management: Everything is management, normal **(Inaudible) 35.15**.

Interviewer: Okay, because exports will be higher receivables, right.

Management: Yeah.

Interviewer: And inventory at this time inventory would be high.

Management: No, in terms of number of days about 60 days.

Interviewer: And in exports, we do realization of say 180, 185, domestic we do 90.

P. Deepak: Just keep in mind on that that this will, the realization will vary based on raw material prices.

Interviewer: That I understand. What would you call, what realization would you call as this being a Specialty Product realization, how much would that be? I am just trying to understand. So, if a product is differentiated specialty, how much would the realization be in comparison to averages?

P. Deepak: I would say at least Rs. 10 more than some of the kind of --

Interviewer: And how much would that have, as a portion of revenues, how much would that be?

Management: Currently it will be about 20%.

P. Deepak: No, no, less than that, I mean, of course, if you group export into that also, yeah, but we were talking about that will grow, even though right now, I would probably say that's only between 5% to 10% that I would consider high complexity, ultra-high complexity where we are able to get an extra Rs. 10 to Rs. 15. Some of those products are these new ones that are making a new plant, right, these type of products, where again, limited competition, there is no competition. I mean, we supplanted a Chinese supplier who was importing this into India. And we are now producing this domestically.

Interviewer: And so this is completely import replacement that we are doing. And are we seeing some tailwinds because the supply chains want to move away from China?

P. Deepak: Yeah. We were looking at, there was actually one --. So, in India, there's hardly any casting that's imported in from China. These were a few of those, we have already gotten into the picture. And in the case of two customers, all of their Chinese imports have now stopped. In the case of one customer, we have developed two parts, they are under testing, once the approval comes, they have got five more, three parts, once approval comes to those three, we have got five more under development. And then the same will happen there also. So, that's probably a six months one year kind of story. Other than that there is not much import into India from China, that's happening anymore. It used to be very different 10 years ago, it's now changed, there is hardly any import of castings into India from China.

Now, if you look at where we see the opportunities in the U.S. market so we are actually on the cusp of getting some new business that is currently manufactured in China. And the customer is looking at resourcing it from us. These are lower complexity parts. So, if you had asked me two years ago, I would have said, you are getting it from China, why even bother asking us for a quote, because I don't believe you would have been competitive. I don't believe anybody in India would have been competitive against China with the kind of prices they were offering.

Obviously, there is two reasons that's driving this change one with the 25% tariffs that that have been put in by Trump, which people thought okay, Trump and she will figure out some deal and they will, it will be over soon, it didn't happen. Then they said, okay, presidential election is coming if Biden wins, he might remove it, that didn't happen either. So, now people are looking at that as a long term cost that's going to be there for a while.

The second thing is reliability of China as a supplier, for two reasons in this particular industry, right. One is, of course, geopolitical. I think people don't want to be as completely reliant on China, for a variety of reasons and most recently, you can even see how the whole Shanghai situation has played out.

The second one is specifically in our industry. There is a concern about China because decisions on the government level seem to be not as stable anymore. It's not as stable a trading partner anymore in terms, we saw last year one of the reasons why this commodity price hikes have happened so much in steel is because they went from being an exporter to saying listen now --

Interviewer: We won't export.

P. Deepak: We won't export, and put, basically export duties from having export incentives, when to export duties. So, there's one question of what is this product is in that. The other part is on the emissions and environmental front. There is a very, what do you say unclear policy of what happens because some of these industries, they just all of a sudden one day decide to shut them down. And they don't know when they are going to restart them. So, they will say, okay, put this equipment, put that equipment and they have to go try to get it restarted. So, that is actually the industry that's, the company is currently producing these parts is having one of those problems and has had those problems.

So, I think, it's probably an overstatement or a bad generalization, but in my view, the reliability of China as a consistent trading partner, the way that it was for the last 30 years, I think, has changed in the last two years. And obviously, the way that the world views China geopolitically also has changed in the last two years compared to what it was in the last 30 years. So, I think there is some discomfort that I can certainly gauge that is also driving this change.

And the other part of it is this tariffs that are there. Obviously irrespective of whatever may have been geopolitical blah, blah, blah, at the end of the day, you are saving money, you go with that, right. And so this 25% seems to be tilting that balance also a little bit more. And U.S. domestically is struggling with capacity issues, with labor issues. A lot of people that have left the workforce are no longer going to come back. And this is not a very preferred industry for people to work in either. So, I think people who had been working there for years continue working there. And now I think when COVID happened, there were some layoffs and all of that, and people found other things to do. So, now when these guys are trying to get people back they are not able to.

Interviewer: But we are not facing any of that, right?

P. Deepak: Well no employee stress or challenges, nothing abnormal, we are not seeing any abnormality there.

Interviewer: Five years out, where do we see the business?

P. Deepak: Good question, I mean, I think we will see exports continue to grow. I think five years out, if I look at it, I think globally, we will be a relevant player. I think what was heartening for me to see actually and a bit of a proud moment when there was this one Analysis Report of casting industry in the U.S. and we were one of the names featured on that even though we are not manufacturing there. And I think we are still early days for us to claim to be one of the top U.S. probably supplying to the U.S., right but there was one of these reports that came out comparing all the different companies. But I think we will get there.

I think, one, I see the U.S. looking very strong for one, because I think of the position that we are in and the customers that we have, the capability that we have, and also the local issues that are there, there has not really been much investment there. Now, they are stuff suffering with labor issues.

The second is, I think Europe, there is a great amount of potential that we will unlock in the next five years. I think Europe is directionally, geopolitically going to move away from Russian gas that is going to drive up energy prices. I am not talking about today's shock energy prices, right. But I am talking about steady state energy prices in five years, will be higher than what they were pre-COVID, undoubtedly, in my view, because Europe does need to invest in their own energy that doesn't depend on Russian gas. It was easy for them to just push off all those investments, because of cost. They could just push that up because they had all this cheap Russian gas coming. Today their inability to pressurize Putin is because they need him as much as, as he needs them. And maybe to some degree a little bit more. So, they are going to work on that and they have made announcements. But that is going to drive up cost of energy. So, I think Europe will also become a very important thing. So, I think we will have a good diversified global mix across.

The other thing that I see happening domestically is I think we have several customers that do want us to come and set up plants closer to them, that they would like us to be at their doorstep. A couple of things, one, obviously logistic cost advantage. But the second part of it is also the flexibility that they get, because they don't have to wait, tell us on our production plan changed can you make this one instead of that one? And there is this whole pipeline of those parts and all these things. So, they would like to have that flexibility as well.

So, I think that is a potential that I could see five years from now that we would have plants located several plants being closer to the customers or where we have at least clusters of customers.

Interviewer: Today how many plants do we have?

P. Deepak: Three plants all in the south between 40 kilometers North of Chennai, and 140 kilometers North of Chennai.

Interviewer: And what will be an optimal capacity to set up a new facility?

P. Deepak: So, you can set up at a variety of these things, you could set it up for as low, I would say, as perhaps 2000 tonnes a month and as high as probably 6000 tonnes a month. Something in that range seems to be where capacities are optimal to setup. So, then it all comes down to when you set up something at 2000 tons per month, how do you manage overhead costs, in terms of the kind of systems and leadership team and people that you need to have. And that's something that we are already working on seeing how we can do that.

Interviewer: And ownership, we own what 72 or 73?

P. Deepak: Right now it's 74.8 something.

Interviewer: And that’s split between you and your sister?

P. Deepak: Yeah.

Interviewer: And she's not in the business.

P. Deepak: So, she is actually supporting us now in the U.S. and managing that entire customer relationship and all other operations. So, she has been doing this, I think since 2019, I am tempted to say maybe late 2018. I requested her support, and she's been doing that since then.

Interviewer: That's nice.

P. Deepak: So, she lives that in the U.S., so it makes it a lot easier. And I would actually credit most of this export growth that we are seeing now, a good chunk of it to the kind of relationships that she's built with the not only the management team, but also the operating teams there.

Interviewer: And she must be speaking the same language and everything, lifestyle and talking about baseball and all that?

P. Deepak: No, so with one of the plants, probably one of our biggest customers in the U.S. they have the Dana plant in Kentucky, she's got a weekly call set up with the operating team. The guy who's the buyer, the Material's Manager --

Interviewer: You can't get comfort like that from anyone.

P. Deepak: So, she has got a weekly call with them. And so she told them that, hey, our purchasing guys, have decided to source this product also from us, which they are buying from another foundry in the U.S. currently. And the buyer says, Great, how quickly can you get me parts? Because I don't want to keep fighting with that supplier to keep getting parts.

So, because of that, also, I think when COVID and all these disruptions happened we never created a problem for any of our customers, we managed to keep them fed through all the volatility that happened, whether it was the slowdown or the sudden ramp up all of that. And the question always used to be is an overseas supplier as reliable as a domestic supplier who is next to you? And I think we have been able to answer that by saying that it's the other way around. I think, you know, us despite being overseas have been over the last two years, much more responsive and consistent and have not been an issue for them for the last couple of years, which I think is a little counterintuitive. You would always think that somebody next door to you would be more reliable and flexible than somebody far away. And I think we have proven in the last two years that it's been the other way around.

Interviewer: Our market cap is 1000 just now?

P. Deepak: No, it's actually I think, obviously recently it's taken a little bit of hit I think it's something in the 600 range right now.

Interviewer: Yeah last I saw it was 1000 maybe some time back. So, market has been very volatile off late so, okay. And total net worth is?

Management: Rs. 430 crores.

Interviewer: And last year's profit was?

Management: PAT was about Rs. 14 crores.

Interviewer: And PBIT?

Management: PBIT interest about Rs. 22 crores and EBITDA was 67.5 minus depreciation of about 22, so about 45.

Interviewer: So, our ROE is as we stand are 10% odd.

P. Deepak: Below, I think last year was about 6% to 7% odd percent.

Interviewer: Where can we where can we take this to? Where will these peak out?

P. Deepak: So, I think if it plays out over the next three years or so that we think definitely I think high teens to 20s seems to be very much in the realm of possibility of how it would play out. But again that depends on the government not coming up with something new and weird, which I hope will not happen. I mean, we didn't obviously see the axle load norm change happening. And that unfortunately set us back three years.

Interviewer: And no intention of building a business in defense?

P. Deepak: So, we are supplying to customers where the end product does go into defense, but we don't have anything directly with the defense mainstream. So, we do produce, so if you see that forward diff carrier, rear diff carrier so when the multi-barrel rocket launcher for which Ashok Leyland supplies the truck and I think it's Saab that's got the rocket launcher behind it. So, we are supplying those two components on that vehicle also, that goes to customer AxleTech, which got acquired by Meritor a couple of years ago. So, we supply this to them, and then they built out the axle and they supply it to Leyland and then of course, Leyland does that integration. I think it's with Saab and some other guys, that they are working together on that whole thing together and supply it to the industry. There are a few brackets that we supply --

Interviewer: How big is this as a proportion, it's small?

P. Deepak: It's quite small.

Interviewer: No, I see defense becoming a very big market. So, I don't know how you can leverage it or whether there is something that you can do in that segment. But this will really explode in terms of opportunity within the country.

P. Deepak: So, defense also, I think one of the things typically produce a sample, it's a couple of years, two way process and then again, it's since it is limited quantities of what they order. So, it can be like a little bit of a cherry on top kind of thing. I don't really see it kind of being that base load. Even if it develops out really well over the next 10 years, I don't see it being a base load business, I think it can just be that little bit of cherry or little bit of icing kind on the top.

Interviewer: I think this is very helpful. Thank you so much. And it's a pleasure to meet you again.

P. Deepak: Good to see you, again.

Interviewer: Can I have your card? I don't have your number.

P. Deepak: I just literary ran out my last one before you walked in. Can I give you my phone number?

Interviewer: Yeah please.

P. Deepak: So, 9884144344 Deepak. I guess I have one in my wallet maybe. I guess my --

Interviewer: No, this is good enough, at least I can maybe message you and take our views.

P. Deepak: Yeah so I mean once in a while I have got a few people in the investment community who shoot me and email saying or Whatsapp message saying, hey Ashok Leyland is saying it's going to provide 20%, do you really think it's going to happen? Or you know and sometimes it's also information I get from the investor community.

Interviewer: Yesterday, I was meeting Subros and we were talking about commentary that Maruti just gave to its dealers. And they said apparently that we will grow 20% volumes this year. And he says, how did you get to know about this? And it's just that we keep hearing from various channels. And this we heard from the distributors. And so he said, Yeah, that's true. We also, we heard about it.

P. Deepak: And I mean, so some of these things, right, like, for example, when Tata Motors came out just a few weeks ago and said, we are going to grow 20%. I had somebody reach out to me and ask me, what does it look like? What is your view? And I said, listen, typically what we see is sequentially from Q4 to Q1, we typically we see a dip of about 25%. This year, we are seeing it be flat to increasing. So, I would buy that commentary that it's 20%. And, and when they are talking to us, they are tongue in cheek saying 20% but we think it could be more kind of thing. They are trying to be a little bit more upbeat and optimistic.

And so Leyland had this thing they call the strategic supplier group. So, it's about 33 to 34 suppliers that they consider to be their most important strategic suppliers. So, they have a meeting with us twice a year as a group, all 30 of us in the room at the same time and they just had one a couple of weeks ago with Dheeraj Hinduja as well as their Anuj, how is I guess President and Sudhir who is the Head of Purchasing. They were very this thing, their projection was at 18%. But they are very tongue in cheek of saying, but we think it could go, maybe even better than 25%. And so you are hearing, they are trying not to be very committal beyond 18%, because that's what they feel is, they want to get held to but there is optimism beyond that.

Interviewer: And why is that? Why would you say is that the case? Because is it that on ground rates are increasing or?

P. Deepak: We are seeing freight rates go up. We actually had a situation this month, where a couple of the carriers refused to take freight from our plant to Jamshedpur, because of the price. They wanted an upward revision price. So, we actually had to get the guys from Tata to call them up and say, listen, you will get compensated on the price, we will compensate Nelcast and Nelcast will compensate you on the freight, you please take this material. And that is the kind of situation that happened in this last month.

So, that's we are seeing freight rates go up for sure. I mean, one of it is, of course, related to diesel cost. But I think we are going to see it go up a little bit more beyond just the fuel pass, I think we will start to see realizations, right. Because realizations matter a lot more now, because of what happened in axle load norm in 2018, why we took that hit, right, the Government's intention may have been good, but unfortunately, the way that it played out was the exact opposite. What I believe the intention was, is they came in and said, they started to crack down on overloading. So, all the transporters basically made money on overloading, right, so they would take on a per ton basis etc. and they will put more in that vehicle and make money. The transporters went to the government and said, if you are going to crack down on overloading, we are losing money, all these problems are there. So, the government said, okay, anyway, the vehicles are designed for overloading. So, there is 20% more that you can carry on the same axle. So, we are going to let you overload 20% legally, beyond that will hold you accountable.

So, the objective was to say, okay, transporters will make a little more. But what happened indirectly as a result of that, even guys who were not overloading because they don't want to be on the wrong side of the law, right, for us, we will never overload a truck. The last thing we want is one of our trucks to get seized at a check post and have to deal with that. We would never do that, right. So, because we would never do that earlier now we can 20% legally. So, if you had the ability to overload it, so all of a sudden the capacity shot up of what was already on the road.

The second thing that happened was with GST coming in and getting more streamlined. The turnaround times also started to get slightly better. I think these two factors, added capacity into the market existing which crashed the freight rates. So, in 2019, we saw a huge drop in freight rates that happened, which was the exact opposite intent of the government, right, that was not the intent, why they brought this in. And the transporters were the one who they brought in for benefit and suffered as a result.

So, then that excess capacity has to get absorbed, unfortunately, GDP growth wasn’t so this thing, so things that capacity, I believe, is now getting absorbed. We saw the first signs of this in November of last year, where I was reading that the price of a secondhand truck started to go up. So, that was the first indicator I would say that I saw in this particular cycle, to say that okay, for secondhand truck people are now trying to buy secondhand vehicles as opposed to earlier there was so much capacity people didn't know what to do the vehicles they had.

So, other than that, when we introduced BS 6 emission norms in 2020, the cost of the vehicle has gone up almost right about 10% to 15% because of all this other after treatment that had to be done. So, now that the cost of the vehicle has gone up, your realization of your freight is lower. So, at some point, this realization has to hit a tipping point. And once it hits that tipping point, then it's a completely different story right then everybody who was postponing their purchases, expecting, because and trying not replacing old vehicles, that the average age of the vehicle I believe, has gone up by a couple of years. So, everybody who was postponing their purchases and not buying new vehicles because a lot of the guys who buy new vehicles sell the vehicle after four years, they kept holding on to them for five, six years. Now they will do that, once it hits that equilibrium point. I don't know if you are at that equilibrium point yet, but I believe we are pretty close.

Interviewer: Because if Leyland is sounding the way it is, then maybe we are close to that point.

P. Deepak: So, that is the part on haulage. In terms of the tippers and those vehicles it's all about infra spend.

Interviewer: Do you supply ACE as well, Action Construction?

P. Deepak: No, we don’t.

Interviewer: Thank you so much Deepak, such a pleasure.

P. Deepak: My pleasure.

Interviewer: Thank you. Bye. Bye. So, you are back today?

P. Deepak: Yeah, we are actually going to go to the airport right now. I think when he stepped over to that side he was just asking the driver to come to the lobby to pick us up.

Interviewer: What time is the flight?

P. Deepak: 07:40.

Interviewer: You are cut to cut because this will be peak traffic time.

P. Deepak: Yeah. So, hopefully we can get there I think within an hour. I don't think it should take longer than that. At least from the few past experiences of going from here to the airport, it's kind of –

Interviewer: But Chennai must be very hot, just now, right.

P. Deepak: Yeah, it was actually, it got a little bit better in May when you got a few showers, because April was horrendous. And then we got a little bit of showers in early mid-May, got a little bit better. Now. Of course, it's gotten hot again. I think when we get a few showers in the next couple of weeks, we should start to cool down again.

Interviewer: How is the business environment with Stalin being in power?

P. Deepak: I think nobody's complaining. I think people seem to be relevantly happy.

Interviewer: Really, because they are, I mean, there is this thing about pay us and get things done at least things get done.

P. Deepak: So, actually I was, you know I was at one of our suppliers yesterday and the talk going on around is --