L RAMKUMAR, MANAGING DIRECTOR, FEELS FY12 COULD POSSIBLY BE A YEAR OF MODERATE GROWTH AS AUTO SALES HAVE STARTED LOSING STEAM

Kripa Mahalingam

"The market is not stagnant but growth could be lower"

Tube Investments of India (TI), a Murugappa group company, operates in three segments: bicycles, engineering and metal-formed products that cater to the consumer, auto and infrastructure sectors. However, the company's fortunes are closely linked to those of the auto sector as it accounts for more than 73 per cent and 60 per cent of the engineering and metal-formed products divisions' revenues. Despite concerns of a slowdown in auto sales in the near term thanks to of high interest rates and commodity costs, the management is going ahead with its capacity expansion programme.
L Ramkumar, managing director, talks on how the company plans to manage growth and costs in a challenging environment and the business prospects in store for the three verticals

- TI contributes 19 per cent to Murugappa group revenues (Rs 17,501 crore) and 16 per cent to operating profits (Rs 2,247 crore) as on March 31, 2011
- The company has significant market share in respective segments: 60 per cent in rolled-formed car doorframes, 40 per cent in chains, 50 per cent in cold-drawn welded tubes
- TI has 60.56 per cent stake in Cholamandalam Investment Finance Company (CIFCO), the group's financial services arm, and 74 per cent in Cholamandalam MS General Insurance
- The TI stock has fallen 10 per cent against 22 per cent for the BSE Auto Index year-till-date

60.7 *%*
Raw material cost as a percentage of total sales, which makes the company susceptible to volatility in steel prices

358 *basis points*
Increase in operating margins from 8.27 per cent in FY09 to 11.85 per cent in FY11. Operating efficiency helped the company to manage the volatility in input prices

Rs **600** *cr*
The capital expenditure planned for the current fiscal (FY12). While Rs 200 crore will be funded by internal accruals, the balance will be raised through debt

Rs **910** *cr*
Total value of investments on its books as on March 31 2011, including its stake in CIFCO and Chola MS General Insurance

PHOTO: RA CHANDROO

→ In July, auto sales saw the sharpest fall since November 2008. There is talk about car manufacturers planning to scale down production. How are you viewing the developments?

← We have already assumed that the growth rate will come down but we must understand that it hasn't become negative. The base has grown in the past two years by almost 45-50 per cent. Now, it is on that larger base that you are going to grow at 7-8 per cent. So the market is not stagnant but on a higher base, there could be lower growth. Hence, the fear of a drastic growth slowdown is not a correct portrayal. The auto industry will continue to grow as people have aspirations and car is a commodity, just like TV or fridge, that everybody would like to own.

→ What will be the impact of the slower growth given that a chunk of TI's revenues comes from the auto sector?

← In the second quarter, growth may be slightly lower but we will still see double-digit growth in auto-related businesses. We might also end up increasing our market share. We have been hit a little bit in the fine blanking business but it is still a smaller percentage of our turnover (3 per cent). We continue to remain strong in the chains business because of two-wheelers. There is a huge untapped demand for chains in the spares market, which we will cash in on. Industrial chains have grown very well in the overseas market. A 12-15 per cent volume growth is definitely possible.

→ Do you think operating margins will sustain at current levels of 11.80 per cent on lower revenue growth? Will you be able to pass on any increase in costs in the present scenario?

← As long as there is no fluctuation in commodity prices, margins will sustain. Otherwise raw material prices can play havoc. With the auto industry facing tough times, players are not going to accept price increases so easily. Hiking prices is not easy, unless you do something very innovative.

→ Why was volume growth in bicycles business stagnant in the first quarter and, going forward, what kind of growth rates do you expect?

← The bicycles market has been growing over the past three years. Though the first quarter of the current fiscal was not great, we managed to grow by 1 per cent, in volume terms. There was probably an inventory clearance that was taking place and also an increase in steel prices (in January-February) saw some manufacturers like us increasing prices, while others didn't. So that impacted our volume growth. But since June, things have corrected and there seems to be price parity across-the-board now. We also had some good institutional orders which managed to arrest the fall in sales growth. But what will continue in the cycles business is the pressure on margins. We are not able to recover as much as we should have. I think, by the end of the year, we will do close to double digits. Hence, the second quarter will be very important for us.

→ What are your capex plans for the current fiscal?

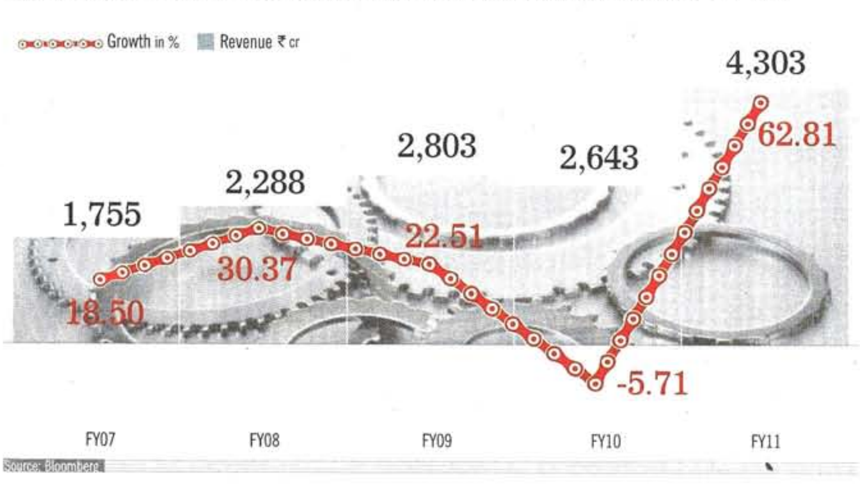
← This year, capex will be close to Rs 600 crore, of which Rs 200 crore will be internal accruals and the balance will be financed through debt. In tubes, we are doing two projects: large diameter tubes for infrastructure projects (which we don't make now) and, in the existing basic range, we are expanding capacity in Mohali by 20 per cent. In chains, we are looking at expanding capacities by 25 per cent at Chennai or Uttaranchal – we already have land in Uttaranchal. In cycles, we are looking at the eastern region and will add another 30 per cent capacity. Expansion in cycles is easier because it is not very capital intensive.

→ Will you put your capex plan on hold in case the demand scenario worsens in the auto sector?

← We will not go back on our plans because this capex will take a year to implement. So, if you cut now, then we are taking a view for one year later (after 2012). Secondly, we have also talked to all auto

Consolidated gains

Strong momentum in auto sales and improved performance by its subsidiaries led to a significant spurt in consolidated revenues in FY11



makers, including Maruti, Tata and Hyundai, and we believe that the long-term growth trend will continue. Everybody is talking about the two million car base becoming seven million. May be it will take six-eight years but I think it's going to happen. In all our businesses, we are operating at full capacity and we have a very large market share. Even if we take a risk, there may be a delay before we start producing at full capacity. But if we don't have enough capacity, we will be inviting competition straight on. So, we are very clear that we will not panic or go slow on capex. We expect the new capacities to commence production by October-November of 2012.

→ Are you saying that the business has the capacity to absorb costs if there is a delay in offtake?

← Yes, there is enough incremental growth to generate operating profits. Our operating margins have also been good over the past couple of quarters. We are also keeping a tight leash on working capital to reduce borrowings. This is a proactive measure that we are taking. It could lead to a problem only if there is too much of a delay but we don't foresee that happening. By the time we have our plants in place, I think the capacity will be utilised. We don't make certain variants of chains, which people are importing from China now. Naturally, that new volume can get used locally. Besides, our buyers are saying that we are not giving enough spares, so there is a gap to fill. This will not go away as the number of two-wheelers is increasing day-by-day. So, it is fairly risk-free.

→ How are you planning to reduce your dependence on the auto sector?

← We are looking at hydraulic tubes for the infrastructure sector, where everything is being imported.

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So we are looking at putting up a plant within the time-frame mentioned earlier. We also sold metal-formed products worth Rs 150 crore to the Indian Railways last year. Our capacity utilisation there was a little affected as they did not release their entire order. But since their requirement is huge, they are an important customer. We set up a plant in Uttaranchal only to cater to the Railways – even if they ask for only 60-70 per cent of what they need, our capacities will be fully utilised. Going forward, hydraulic tubes, the Railways and industrial chains will comprise the bulk of the non-auto business.

→ How difficult is it for you to manage interest costs?

← It's difficult because it's going up every few weeks. Our strong credit rating helps us get the best possible rates. Our interest costs, on average, are 8.5-9 per cent, for both long- and short-term loans put together. We are already drawing on the Rs 100 crore non-convertible debentures we raised at 9.9 per cent. We are also looking at external commercial borrowings to raise $50 million, which will be fully hedged.

→ What was the reason for the sharp jump in consolidated debt in FY11 from around Rs 2,450 crore to Rs 8,747 crore?

← The difference is due to the basis of consolidation of CIFCO's financials. There has been a change in the status of TI's investment in CIFCO, which has changed from a joint venture to a subsidiary with effect from April 2010, subsequent to our taking over DBS' stake. Hence, as per the Accounting Standard (AS-21), the financials of CIFCO have been combined on a line-by-line basis. In the previous year, CIFCO's financials have been combined based on the joint venture accounting standard and, hence, the figures are not comparable. The borrowings are largely by CIFCO as part of its usual business flow and it is comfortably poised to service those loans. There are no major repayments from TI's side for FY12.

→ Are you looking at divesting stakes in CIFCO and the insurance arm? If the subsidiaries need to raise capital, how do you plan to fund it?

← It has been decided at the group level that if there is any need for resources, either for financial services or TI, and that requires a different structure like a holding company, or divesting or diluting, we would not be averse to doing so. But that is a long-term view, there is nothing at the moment and all capex requirements are being met. □