"Carborundum Universal Limited Q1 FY18 Earnings Conference Call"

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Moderator: Ladies and Gentlemen, Good Day and Welcome to the Carborundum Universal Q1 FY18 Earnings Conference Call, hosted by Kotak Securities Limited. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Aditya Mongia from Kotak Securities Limited. Thank you and over to you, sir.

Aditya Mongia: Good Day, everyone. For today's results conference call of Carborundum Universal we have from the company Mr. K. Srinivasan – Managing Director and; Mr. Sridharan Rangarajan – Chief Financial Officer and Mr. Raja Mukherjee – Senior General Manger, Internal Audit and Strategy.

I would now want to hand over the control of the call to the management for their opening remarks. After which we can open up the call for questions from participants. Thank you.

K. Srinivasan: Good morning, Aditya. Thanks for hosting us. And good morning to all of you who have joining in the call. At the outset, apologies for my bad throat, but that has nothing to do with celebrating the results as much as due to infection out here.

Let me start by saying that we all went through a quarter which was probably unique in itself for we are going through a major transition in taxation systems. And during these kind of first of its kind experiences, the calls we take are largely driven by our outlook of what we expect going forward. One of the calls that we did take during this quarter was to say that we are not going to pass on any kind of discount or compensation to the trade to push sales, because there was this transition requirement on GST where at the end retail they could only recover 60% of the final billed amount. And consequently, there was a big clamor for discounts or compensation to push sales. And we took a call based on our outlook of what we expect for the year that we would not do this.

We expected to take a Rs. 25 crores at least as a lower sale, but it ended up even higher than that, we probably took about Rs. 35 crores lower sales than what we thought we could otherwise have done. But having said it, I must tell you, on a consolidated basis, we still grew by 3%, standalone de-grew by 3%, the top-line was flat on consolidated at about Rs. 41 crores and the bottom-line was flat on the consolidated and bottom-line was negative by about 20% on the standalone.

I will then jump to the respective businesses before I come to the numbers.

Abrasives was the one which was impacted seriously by the GST transition issues, I explained what was expected and what was our option. We believe going forward that the trade prices would harden, it would actually go up. Consequently, we did not want to disturb the market by giving any kind of a discount, there is generally between 3 months to 4 months inventory in the pipeline, we did not want to discount it. We took a lower sale; our inventories went up and we hope that this would be compensated by better sales and margins in the ensuing quarters. As we speak, we have just completed July, and so far, I would say that our call to not to discount the product was probably turning out better.

International business saw good traction, our exports grew, our businesses in abrasives in Russia, in Middle East, in US and China, all did better than what we expected. So, there is a general level of buoyancy in the market for abrasives. Our plants are running efficiently, we have been practicing PPM, two of our plants already are JIPM and TPM certified, two more have cleared their internal audits, so we expect them to get certified.

The work through DSIR approved labs in these two factories are running well. We have filed a few patents, some what we call as products of the future have already been put in the market for trials and we expect this to get into volume production in the coming quarters. We clearly see the operating price in the market going up, this is going to be driven by input price going up as well as market prices going up on account of the trade becoming more expensive. So, this should give us a volume and value growth going forward.

On the subsidiaries in abrasive space, Sterling did well, they grew by almost 15%, largely on the back of agri products and exports. Wendt was relatively flat, but again, they have order back log to take them forward. So, abrasives, I would say, performance looks muted but all the indications both global indications as well as domestic indications point that Q2 onwards things should get better.

The Electro Mineral vertical, this is a vertical which will probably see a lot of action and this is a vertical probably I expect lot more questions as well. The domestic market grew by 11% for us, but that is a small part of the story, because all our major investments have happened here, our costs are already in here and we were not running the plant to full capacity as of now. Input prices are going up here. In terms of electricity, prices are up, price of electrodes is up, Zircon sand is up and all this is translating to a certain amount of price going up in this product across the world. We expect this price increase to play out in the next three quarters and we would see a significant growth in price of these products as well as sales.

Volzhsky is a good example of what is happening outside of India. It was running flat out, we did more than 20,000 tons as expected and we did a post-tax profit of over RUB230 million. So that was running flat out.

In terms of fusion facilities, all our plants in EMD are running, they are all commissioned, operational, trials are over, commercial sales have stared. So, as I speak, July has indicated that the scaling up has already started, price going up should play out in the next couple of quarters.

We are doing record tonnages as I speak, but we are yet to see the record profits in sales, hopefully should come in Q2 onwards.

Zirconia business on Foskor Zirconia is still to stabilize. We probably would end up using more of these capacities to do semi-finished inputs for our Electro Mineral business rather to run Zirconia flat out to make end customer product as a step to keep Foskor Zirconia more profitable.

Let me jump to the Ceramic vertical. The industrial ceramic, again, I will take it in two parts. General pickup in Wear Ceramics in India, in America, which is really what goes in the power stations, mineral processing, etc., good sign. The Technical Engineered Ceramic was actually slightly impacted, I would not say big impact but slightly impacted several customers, particularly in the power transmission sector, etc. They did not want to pick up material in the first quarter because they would lose the 2% CST. So they said we will rather pick it up in July. We did not push, we did not want to compensate again and we said we will take a lower sale. With this metalized cylinder plant 2 also coming into production in Q2, we expect big step jump coming up in Q2, Q3 onwards.

Indication of what is happening outside, the Australian had record sales, record profits. We are moving from just supplying to the coal mines to more into the mineral processing area. We are getting more into product oriented sales to more service installation oriented. So, really the Industrial Ceramic part of this vertical is doing well, but the numbers you will see going forward getting better.

On the refractory side, general pickup in the steel market and consequently refractory orders are picked up. Copper is doing well after a long time, so we are getting big orders for copper smelters out of Africa and other places. Our Metflow project for steel flow products is established now, we have won customers. The mid-size and smaller steel plants were not very strongly operational in Q1, we expect it to pick-up in Q2 going forward. The challenge that this vertical is going to face is all the input cost increases would also come into this vertical and we would in-turn have to pass it on to the market. This market is notorious for not giving price increase, so that is a battle we will probably face going into Q2 and Q3.

Indication of the global, I would say the nitride bonded Silicon Carbide business in Volzhsky is running flat out. We are completely out of capacity, this largely caters to the aluminum and the non-ferrous industry. We probably will put in more capacities going forward to produce more of this product. So, again, this vertical is globally doing well, getting better.

So, that is broadly on all the verticals. We spent about Rs. 35 crores of CAPEX in the first quarter on a consolidated, we expect to close the year with our Rs. 100 crores of CAPEX. We are very positive about what happened so far, our call was based on the fact that we think that price is going to go up there was no need to go and discount the market. We planned that we would have a lower sale but we ended up with a lower than the lower sales that we planned, we hope to catch up in Q2, Q3.

With that, I will ask Sridhar to take up on the numbers.

R. Sridharan: Good morning to all of you. I think it is a historical event that we went by, GST migration, so it is an unprecedented quarter. With that background, I will cover the financial result as well as some of the GST impacts.

At a consolidated level, we registered a sales growth of Rs. 14 crores over the last year, the operating PBT dropped by Rs. 3 crores. Standalone sales were lower by Rs. 10 crores and the profits were down by Rs. 10 crores. The Rs. 10 crores drop came mainly because of lower volume, power cost and fuel cost going up, higher depreciation and personnel cost because we are comparing Q1 of last year versus the Q1 of this year.

Power and fuel costs went up due to tariff increase in KSEB by 25 paise per unit, as well as the lower rainfall in Maniyar, this is the second year in row where rainfall is lower. And the fuel cost increases you all know about that.

Subsidiaries sales increased by Rs. 24 crores and PBT increased by Rs. 7 crores, this is mainly due to better performance in VAW, VAW has done about 2,600 tons in higher volumes which resulted in better profits.

For sequential movement, at a consolidated level we registered a sales drop of Rs. 41 crores. The operating PBT was lower by Rs. 10 crores mainly due to lower sales. Standalone sales were lower by Rs. 5 crores, leading to a drop-in profit before tax of around Rs. 18 crores, I am talking net of dividend from inter companies as it gets eliminated in the consolidated result. The drop was attributed mainly due to the lower volume and export benefit is purely the timing of the accrual. Subsequently, sales went up by Rs. 14 crores and the profit before tax gained by about Rs. 8 crores, this happened again predominantly from VAW. And VAW had higher sequential volume by about at least 4,000 tons.

Now, we will go the segment wise coverage. Abrasives, PBIT margin in abrasives moved from 10.6% in quarter one of last year to 10.89% in quarter four of last year, it was 9.2% in the current quarter. So the drop in PBIT in absolute terms compared to Q1 last year is Rs. 5 crores, the entire drop came from the lower volumes in standalone business. The PBIT drop in absolute terms compared to Q4 is about Rs. 6 crores, the drop predominantly comes from the Indian abrasive business which is again resulting into a volume drop.

As far as Electro Mineral is concerned, the consolidated PBIT margin of Electro Minerals increased by Rs. 3 crores on a quarter-on-quarter basis. Standalone EMD business, PBIT was lower by about Rs. 4 crores, predominantly due to the higher power cost, fixed cost associated with new process and the lower utilization of the capacity which was put in. Higher profit in VAW was due to the better performance, largely the volume driven performance. On a sequential basis there was a Rs. 7 crores increase, this has come predominantly due to better performance of VAW. Sales in VAW was higher owing to the favorable volume that we had compared to the prior quarter.

Ceramics, PBIT margin of Ceramics was lower by about Rs. 60 lakhs, mainly comes from the Indian operations due to the lower volume and better profits from overall subsidiaries, offsetting the lower volume that we had in the domestic business. On the sequential basis PBIT was lower by about Rs. 5 crores, which again predominantly came from standalone. On the CAPEX, we did about Rs. 35 crores and we expect the full year to be Rs. 100 crores for the financial year.

On GST, I think I will quickly walk through that. CUMI's cost structure predominantly consists of raw material, power, fuel, consumables and employee compensation overhead. Most of the major input materials like silicon carbide, alumina and other grains that go into manufacture of our products of CUMI are majorly imported as well as sourced from its manufacturing plant as well as other manufacturers in India. The duties and taxes paid while buying these products have been availed as input tax credits in the earlier indirect tax regime, we will get the tax credit in the GST regime as well. So, combined incident of tax rate for these products remains unchanged in the GST structure, hence there is no additional input tax credit benefit flowing because of the GST introduction.

Power is another critical input in our manufacturing, indirect tax that was paid was not part of the tax credit earlier as well as now, so we stand the same. Fuel is yet another key input, again we have a mixed position here. There are certain fuels which are still under VAT, for those we are not able to take input tax credit, hence we may have some small impact.

CUMI was hitherto availing most of the input service tax credit relating to the services received, which is now subsumed by the GST. Again, here it is noticed that there is no change in the cost structure for the business, however, it is involving higher cash outflow due to the increase in tax rates. There are certain services like employee welfare, canteen and other related services which are still outside the credit eligible service under GST, thereby continuing as cost at a slightly higher effective tax rate. These costs to some extent were offset by the tax credit eligibility on services like outward freight cost which we earlier did not take the credit.

The compliance cost under the GST is expected to go up. So, if you put all in all, I think we will have marginal costs or marginal benefit by product if we really look at it. And practically, all our products are fixed at 18% with few exceptions. By and large we feel overall incidents of indirect tax versus the GST has very marginal cost or benefit, depending on the product group which we look at it.

Our systems are redesigned and we were able to start invoicing from the first working day in July. Our transitional credits, whatever we need to take are well in order and we are properly doing that. We still have a few vendors yet to get their GST and there are few teething issues, we address each one of them as it crops up.

As far as debt to equity is concerned, standalone debt to equity ratio is at 0.02 as of June 2017, slightly high compared to the zero debt position as of March 2017. Our inventory has gone up by about Rs. 55 crores, Mr. Srinivasan covered earlier about that, so that has resulted in a slight increase in the working capital loans. And on a consolidated basis debt equity ratio remained 0.11 as of March 2017 to 0.12 as of June 2017. The total debt on a consolidated basis is about Rs. 165 crores, the net debt could be in the range of about say Rs. 20 crores or so.

And with that, I think I would like to summarize. GST is implemented and systems are redesigned. GST has impacted our abrasives sales, we expect a normalcy to come in the remaining quarters. As earlier said that we have taken a call that we will not discount the price and we will go through this as it comes. Industrial ceramic sales drop in Q1 is due to the postponement of certain orders and this will happen in Q2, so that is not an issue. EMD, the Bubble Zirconia production has started and we made our first sales. We expect the sales to pick-up steadily.

So, by and large I would say, pretty much in line with whatever we had been communicating. So, GST is an unknown thing and we have just so far crossed kind of 30 days in that new model of taxation. Our result so far in July is encouraging, so we think that we could broadly end the year about Rs. 2,400 crores, this is without excise duty because in the next three quarters you will not have excise duty and it will not appear as part of the sales, compared to Rs. 2,100 crores without excise duty of last year, I mean this is again if you have to do an apple-to-apple comparison. So, I think by and large our trajectory whatever we are communicating will remain same. And we expect to get better performance in Q2, Q3 and Q4.

With that, I think we can open up the question-and-answer session. Thank you.

Moderator: Thank you. Ladies and Gentlemen, we will now begin with the question-and-answer session. Our first question is from the line of Pawan Kumar from Unifi Capital. Please go ahead.

Pawan Kumar: Sir, can you just give us an indication of where the CAPEX is going to be? I mean, Rs. 100 crores CAPEX, whatever we have guided, where are we investing?

R. Sridharan: It will be typically the maintenance CAPEX, we earlier communicated that there is no new capacity addition as such, there will be marginal capacity balancing that could be there. But typically we spend about Rs. 70 crores or so in the maintenance CAPEX.

Pawan Kumar: Okay. So, this is nothing related to creating any new capacity?

K. Srinivasan: Correct.

Pawan Kumar: Okay. And coming to Abrasives, Ceramics and Electro Minerals, so where do we have spare capacities right now, because from what you indicated VAW is almost running at full production and lot of other facilities are running at full production. So, where do we have…

K. Srinivasan: Abrasives is running probably on an average about 60%, we have significant capacities in India and in Russia. Ceramic is also running. If I look at Refractories and Industrial Ceramics combined, again about 60% because the new Metz cylinder plant is just coming into production. We have capacity in refractory, so again 60% - 65%. Electro Minerals, again all the new plants have just come into stream, we still can put through something like about between 15,000 tons to 18,000 tons of various grains through the EMD system. And we probably can put through may be another 2,000 tons - 3,000 tons. So, really we have significant capacity and we have been saying that what we have as a CAPEX project announced and implemented, some of it is also getting completed now in the first quarter would take us through the new calculation number, because we now take off the excise from the start to somewhere between Rs. 3,200 crores plus. So, that is the kind of capacity delta that is available.

Pawan Kumar: So, Rs. 3,200 crores, if I had to take a base, so over a long-term what would be at least our internal target to reach those kind of levels going forward, maybe in three years, two years point of view?

K. Srinivasan: We have been saying we will do it within three years, and let's see how it goes. Because I think we are going to hit in the next three quarters a kind of a rapid growth and that will sort of set the context of when it is going to be.

Pawan Kumar: And would my understanding be right that there is going to be a significant amount of operating leverage which also will be under played if the capacity utilization does ramp-up?

K. Srinivasan: Absolutely, because most of the plants have been invested in and also the operating personnel for all these plants are all in place, and they are at the moment not contributing anything to the top-line.

Moderator: Thank you. We have the next question from the line of Ujwal Shah from Quest Investment Advisors Pvt. Ltd. Please go ahead.

Ujwal Shah: Sir, needed your outlook on the VAW capacity, the power situation over there and the global silicon carbide pricing scenario as of now?

K. Srinivasan: See, we are seeing Volzhsky's capacity at the moment is about 80,000 tons, the only constraint if ever that comes up is the ability of the external grid to put power into our system. At the moment, they are giving us full supply and we are running it flat. During the next 18 months or so we will try and increase this 80,000 tons with a certain amount of internal efficiencies as well as change in some equipment by trying to bring in another 10,000 tons which could take about 18 months. So, we will probably go to about 90,000 tons. At the moment it is 80,000 tons, we are running it flat. We will see how to get the additional 10,000 tons in the next 18 months.

As far as your next question on power cost, we are running at RUB2.32 at the moment, we expect it to remain around this level for various reasons, I do not think it is going to go down because the power cost there is dependent on a certain level of political support that is required for the country around that. So, we need to pay that price and we pay RUB2.32 at the moment, it is going to stay there. Price of silicon carbide in Dollar-Euro terms actually went down by about 5%. But what we have is number that our tonnage went up by 4,000 tons or it will go up by 4,000 compared to last year, so that is going to give us a benefit. The price in Ruble terms in the domestic sale actually went up, so that overall helped us a bit. The exchange rate for Ruble have strengthened so far, so that has been a bit of a negative for exports, positive for other things. So, that is broadly what it is.

But globally, silicon carbide price this year seems to be at least bottoming out, it is not going down any further. We expect going forward in the next two, three quarters it will actually creep up. Two reasons why it will creep up, one is, the weighted average price going up would come from a better product mix, more crystalline material, more FEPA grits which go to the abrasive, refractory industry rather than the metallurgical, that is one. The second one is, there is going to be a certain amount of global requirement coming up which is not met by any of the new capacity getting started. So, to that extent the demand will ensure that prices start creeping up. Yet to see it but definitely bottomed out, so Q2 and Q3 I expect at least a marginal price increase kicking in.

Ujwal Shah: Right, sir. And sir, during your initial comments you did mention that you are expecting domestic abrasive prices going up, as well as some challenges on the ceramic pricing side. So, can you just throw some light, where do we see that and by what extent do you see the pricing going up for the abrasives as well as what kind of pricing increase would be required on the ceramic side?

K. Srinivasan: I will take the ceramic part first. Ceramic has two parts, one is the Engineered or the Industrial Ceramic part, here the price increase is going to be fairly muted, it is not going to be anything big. The refractory part of it would have to see a price correction anywhere between 5% to 10%, it has to go up. Largely coming out of what Sridhar had covered in terms of input cost going up, so consequently that has to be passed on to the market. And I did mention that we are selling in to some of the industries which are notorious for not giving price increase, so that is going to be the battle that I see going forward in Q2, Q3. But this impact of cost increase is secular, everybody is facing it so everybody needs to put up prices. So, this is something that will play out. But industrial ceramic is B2B, direct customers, tied-up customers, so there the price increase whatever is required will be small but it will be done very quietly.

Coming to abrasives, a little more complex, here again they have this cost increase coming in. Here there is two kinds of dynamics in play, one is what we call as a market operating price which is determined by the amount of imports, the amount of trade products, amount of products that come from not so organized kind of supply chain. And these are all going up. Consequently, the operating price in the market is anyway going to go up, there is going to be a cost push related price increase that all our big companies like us would all have to pass out as well. So, I think two things will play out, there is a cost required price increase that we will implement, but this is going to get supported more in the end consumer place because of the market operating price will also start moving up. So, abrasive is going to see, I would say, a far significant price correction happening at the end point.

Ujwal Shah: And that would be in what, if you can quantify it, sir?

K. Srinivasan: I would leave that to play out, because I want to be a little careful on this because we are talking of things which are outside of our control, in the sense we have to take a guess on how much of this is the trade import which was happening earlier and how they are going to get more organized. You read as much as I on the IGST growth. We are talking of IGST growth in the one month of 60%, about Rs. 10,000 crores growth, etc. If everything is going to come through the organized imports the market operating price can go up significantly. Let's see how it plays out.

Ujwal Shah: Sure, sir. And sir, on the electro mineral side, for the standalone business the margins were very tepid during the quarter. So, what is the outlook that we have for the year ahead, considering that Maniyar would be facing challenges this year as well?

R. Sridharan: See, we communicated this earlier also, I think we expect somewhere in the range of similar to the last year about 6.5% to 7%. Because this is after offsetting quite a bit of cost increase that we are looking at in terms of the power cost increase as well as some of the input material cost increase.

Ujwal Shah: And sir lastly, update on Chinese operations and US operations, if you may?

K. Srinivasan: The Chinese operation has stabilized, like we said we have already taken out all the cost, so it is now a pure play outsourced manufacturing and sales doing well, they are doing their sales, they are collecting their money, we are not keeping any big numbers for them to shoot at and they are doing well. The US operations still loses marginal money, but that again is a conscious decision of investing in building the brand, sales and distribution, but the sales is going up. So, I would say, both of them will comply.

Moderator: Thank you. We have the next question from the line of Balchandra Shinde from Anand Rathi. Please go ahead.

Balchandra Shinde: Sir, regarding our restructured and relocated entities, can you specify how much will be the incremental revenue we will be able to generate this year?

R.Sridharan: See, I think broadly in the electro mineral space my expectation would be in the range of about Rs. 50 crores to Rs. 70 crores will be there.

Balchandra Shinde: Okay. And sir, on the profitability front, will these be for the domestic demand or we will export from India?

K. Srinivasan: See, the plants that we have brought from South Africa, the Bubble Zirconia plant is located in an SEZ, so by definition we expect a significant part of it to be exported. The other plant is in domestic area where we expect a significant part of it to be consumed locally. So, like what Sridhar said in this year's additional sale of between Rs. 60 crores to Rs. 70 crores, I would say more than half would be exports and less than half would be for domestic.

Balchandra Shinde: Okay. And sir, regarding the power cost increase which you said has happened at Kerala, how much impact will it have on abrasives and ceramics margin because of that?

R. Sridharan: See, the power cost increase by and large will be in the range of about Rs. 5 crores is our expectation. Now, this is to be passed on to various customers, including our internal customers. So, typically let's say 30% to 35% is consumed by the internal customers. So, to some extent the pass on will happen to the internal customers, but predominantly will be external customers.

Moderator: Thank you. We have the next question from the line of Pawan Parakh from Bank of Baroda. Please go ahead.

Pawan Parakh: Sir, my first question is on this silicon prices, you said that these prices have fallen and Rupee has also appreciated. So, actually you should have got some benefit on the domestic operations as well, right?

K. Srinivasan: Pawan, could you just repeat the question for a second, please?

Pawan Parakh: Sir, my question was, silicon prices have fallen and Rupee has also appreciated, so in that sense our standalone Electro Minerals business also should have benefited from it?

K. Srinivasan: I think probably you mean silicon carbide, so let me answer. The silicon carbide price in rupee terms actually has been almost flattish, it has not gone down any significantly. In Dollar-Euro terms, silicon carbide in Europe has gone down last year by about 5%, this year we expect it to bottom out like I said. So, there is no benefit because almost all the silicon carbide that we sell in India is made in India, so it is constant in Rupees, sold in Rupees, no major change. So, we did not get any benefit. We do import some amount of crude from our Russian plant, process it and we export it back to our SEZ. There again our import was in Dollar-Euro and export was again in Dollar-Euro, so there is really no major advantage coming out of any currency thing. We got it at a lower price, we sold it at a lower price. So, by and large rupee exchange rate did not play any kind of a roll in this business.

Pawan Parakh: And secondly sir, I mean, our EMD business margins are pretty low at 2%. Now that we have commissioned new capacities and may be at the beginning there will be some initial costs, so is it a fair assumption that for the full year 2%, 3% where the margins will be for this segment?

R. Sridharan: No, I just mentioned this earlier, we expect about 6.5% or so for the full on the standalone basis.

Pawan Parakh: And that considers the cost related to the new businesses, the price hikes that you are going to take in your existing product lines and everything?

R. Sridharan: Yes, correct. And with the lower capacity utilization, because we will not be operating at let's say kind of 80% - 85% capacity utilization in newer plants.

Pawan Parakh: Okay. And sir, on the abrasives side you said that the business was impacted because of GST, but ceramic sales are also down. So, is it purely to do only with some of the sales which got postponed on the engineered ceramics side or there was some GST impact here also?

K. Srinivasan: Like I said, both the refractory business and the industrial ceramics business did have some postponement of sales, largely because otherwise we were expected by the customers to give a 2% discount for the GST transition. VAT or the CST part of it credit was not available. They said that you better bill us in July. So, consequently it is a GST related operational issue which cost is deferment, we expect to catch up.

R. Sridharan: Also, some of our products or CAPEX items for the customer, no one wanted a transitional flow of CAPEX in transit for the last two weeks. So, that was one of the reason for this delay as well.

Pawan Parakh: And lastly sir, on that metalized cylinder size, until now largely this product was sold for the power T&D industry, is that the case even now and how do we look at it going ahead?

K. Srinivasan: This product primarily addresses the vacuum circuit breaker which is used in the T&D business, it will remain that way. It would be about 25% max sale in India and 75% for exports, Europe, America, even China and other places. And they will continue that way. With the NTK NGK plant coming in, we will also now start addressing the traditional NTK customers in Japan, Korea, etc.

Moderator: Thank you. We have the next question from the line of Bhumika Nair from IDFC. Please go ahead.

Bhumika Nair: Sir, obviously in this quarter there has been a lot of GST related disruption, which will probably iron out during the next couple of quarters. So, how should we look at in terms of the full year, I mean will there, and there are obviously input cost pressures apart from the GST related pressure that we felt in this quarter. So, how do we look in margins for the full year across the various segments?

R. Sridharan: Bhumika, see as far as full year broad margins, at this point in time what we feel is that if one has to restate the top-line on the net sales basis without excise, and comparable apple-to-apple also on the net sales basis, we expect abrasives margin could be in the range of 13% to 13.2% and ceramics could be in the range of about 14% to 14.5% and electro minerals about 6.5%. These are all on standalone basis.

Bhumika Nair: And sir, how would it look on consol basis?

R. Sridharan: Consol basis, my expectation on the abrasives side would be about 12.5% plus to 13%, ceramics could be in the range of about 15.5% to 16.5%, electro mineral could be about 12.5% to 13%.

Bhumika Nair: Sir, I mean, you mentioned that this year we would be from the new facilities doing revenues in the range of about Rs. 50 crores to Rs. 70 crores. And on a full blown basis we can do much higher, so how is your ramp-up happening, how is the new customer acceptance for these kind of products or have we been able to reach out in terms of exports, etc. If you could throw some more color on that we would really appreciate it.

K. Srinivasan: Yes. The electro mineral plant has been commissioned, we had our global customers there with us in last month and we have had first shipments going out to all our key customers abroad as well as in India. So, the trial supplies are over, regular supplies have stared, so that is a very positive thing. We will be very careful about longer-term contracts, see like I mentioned we were also going through a phase where there is going to be a climb on prices, so we do not want to end up in a rush to get into low prices with the input costs going up. So, we are entering on shorter term contracts to push quantities as well. So, product is established, product is accepted, key customers have placed regular orders and picked up materials, so that is a good thing. In the metalized cylinder parts, actually the second cylinder, the plant has been tested, approved by the NGK team here. Customers have taken their first product shipments and they have accepted our products because every time you bring it from a new plant they will have to go through what is called as life cycle testing, because these products have to last for 25 years. We have got clearances from two major customers, so we will start ramping up Q2 onwards. So, all the major investments made last year are technically proven, fund supply is completed, commercial production started, scaling up happening.

Moderator: Thank you. We have the next question from the line of Vaibhav Kapur from PPFAS Mutual fund. Please go ahead.

Vaibhav Kapur: Sir, if you look at your corporate presentation, there is a page titled the Spirit of Murugappa Group, you all talk about the five lights, quality, integrity, passion, respect and responsibility. Sir, could you explain with some examples how you have taken decisions in our company incorporating these value and principles?

K. Srinivasan: Thanks for asking this, because we actually live by these five principles in all what we do every day. We have actually put out several videos actually on the internet on each of these five and I will be happy to share some of this with you, because this we have share anecdotally how this is the way we live, this is the way we take all our calls and that is the way it has always been for us. Quality in everything, not only products, in terms of the services, in terms of the way we cannot sack the people, in everything that we do. Respect not only for people in the system but also for the processes, also for our external stakeholders to all of them, respect. Responsibility for all our action, responsibility in terms of what is bestowed on us and we value that. Integrity, of course not only integrity in the smallest term of financial integrity but also integrity of ideas. A good example I can give on this is actually we believe outlook is positive and we said that we should take that call and which means that we will not say outlook is positive and then go and discount a price for one month sale. So, in all our calls, many times it would be in contrast to the traditional way of doing things, we have lived with these five lights in all our actions.

Moderator: Thank you. We have the next question from the line of Aditya Mongia from Kotak Securities Limited. Please go ahead.

Aditya Mongia: Sir, I had a question more on the abrasive segment and more so on the competition in the domestic market. So, one of your key peers in the annual report have mentioned that this market becoming more of a multi-player market versus a two-player market. And reasons cited over there and that is why I would want to get your feedback is that, A) the European players are finding it difficult to have enough demand from their home country and focus is increasing. And B) that Chinese imports are expected to be more price competitive in the GST regime. So, just thought I will take your feedback on both these issues as you see them for the domestic market in the abrasives business. Thank you.

K. Srinivasan: I would only say that each of us take an outlook and our outlook determines the actions we take. Our outlook has been very positive, we believe with GST coming in the kind of imports at the bottom end of the pyramid which were not all overboard, which will all be let's say grey to say the least, coming out of trade, Chinese, etc., would actually dramatically decline. The so called European inputs into India, the name would be European but almost all the products that these companies bring in, I would say without any exception more than 60% plus of all the products they bring in actually come in from China. So, really as things get into the IGST mode and to more organized transactions and trading, we believe this market would be better serviced by people who manufacture in India, sell in India and service in India. We believe the operating prices in the final product would go up, we believe that companies who are based out of India and operate in here would have an advantage, both in terms of competitiveness as well as serviceability of the market. So, our outlook is still very positive and we believe this is a growing business and the margins are likely to get even better.

Aditya Mongia: Sure, that is very helpful. One more thing which I wanted to ask, you did say that there was a muted impact wherein you lost certain share to peers because of the GST event playing out and us having a stand on maintaining pricing in the market. Just wanted to get a sense from what would have happened from the way the customer feels, have those customers started again ordering abrasives from you or it is still a wait and watch approach for them at this point of time?

K. Srinivasan: Let me clarify like this, one month sale not happening to the primary would not translate into any change in the market share. You could prepone your sale into your primary channel by a discounting or a compensation, and it only moves from my shelf to his shelf. It is still not into the consumers end to materially change market share. So, I would not rush to say that this, I would say our decision not to put sale into the primary is only to ensure that the channel trade does not lose margin and they are prepared, see we do not want to travel south when our intention is to travel north. There is no point in going and putting a discount in the market and then after two months putting up prices. So, we expect prices to definitely move upwards and there is no reason to push the primary by a month. So, first is, I would say this, sale which we did not do last month would not translate with the actual reduction or change in market share, that is the first submission. Because it is not an actual consumer point sale, it is only sale to the primary.

The second question, customers who postpone, yes they have postponed but they all have already started taking in July, except some of those automotive customers who are still stuck, I mean quite a few of MSMEs are all stuck with working capital issues, etc., and that is something which is going to play out over a period of time, it is going to take Q2, Q3. But the actual end consumer who actually puts the wheel on the job and consumes, there I believe there is no market share shift as of now, there I believe the prices are only actually going to go up and we have to handle it carefully going forward.

Aditya Mongia: Sure. If I may squeeze in one more question, this is on the electro mineral business outside India, specifically Russia. What factor would play out for us to be thinking of a fairly large addition to capacities over there versus 10,000 tons being planned over the next two years?

K. Srinivasan: See, 10,000 tons over two years, I am being careful, but we will do incremental. So, it is not going to happen one shot at the end of two years, we hope to sort of do some correction, that is why I said we are going to do some process changes, some incremental improvements which will eventually give us 10,000 tons in the next 18 months, we will do it in a creeping manner.

To answer your fist question, what would it take to put in big capacity? Challenge in doing this is Russia today is still at a point where it is in conflict with the western world and America. For us to make a big commitment there with a significant part of the markets being Europe and rest of the world, this is a question that worries us at this stage. They are still the lowest cost producer, our operations are outstanding there, we have the greatest of respect and regard for the technologies and the people that we work there with. But it is a question of country risk at this stage, who you would want to put in some more capacities at this stage. So, let's do the incremental improvements initially and we would come back. We have an approval, the government is supportive, we have an internal clearance that we can take up a big project. But we are just looking for an opportune moment to go ahead with it. And in the meanwhile, we have these big capacity increases that have come up in India, we would like to maximize this. And then by the time we would also be ready to take a call in the next 18 months.

Moderator: Thank you. We have the next question from the line of Sandeep Baid from Quest Investment. Please go ahead.

Sandeep Baid: I had two questions. One, you mentioned in your initial commentary that you have filed a few patents with regards to some futuristic products and that you expect commercial production to start in some time. Just wanted to check whether you can give some more details, what is the timeline that we are looking at, what kind of volumes are we looking at, will these products be of much higher margins?

K. Srinivasan: Happy to have this question. We have filed patents at the electro mineral division, we have filed patents in the abrasives division. The patents generally are for newer minerals in the abrasive division, this also protects what we make and the variance that we make. It improves our sale of the raw material and our cost competitiveness as far as the electro mineral division is concerned. In abrasives the two patents that you have filled are largely on what we call as smart products, products that eventually would be interactive with the environment, which means to the job, the workplace and the machine can interact. So, to start with, the volumes would be small, but these are step jumps and these are technological changes which will make a difference with the ecosystem and drive us in to the newer areas of manufacturing. So, we will scale up incrementally, no major CAPEX is going to go into work. And as customers start converting we would have the products ready for them. So, this is all now at a stage where we are just getting products to hit alpha, that means it is going to get into the actual working environment so we start getting feedbacks and perfect it. We have to file a patent before we do commercial, so that part is over now.

Sandeep Baid: Right. So, in terms of timeline we are looking at launching these products commercially by Q3, Q4 this year?

K. Srinivasan: Yes, there are not going to be any big launch, I mean they will gradually break in to the customers and gradually scale up. Like I said, it is not going to be a big launch, new equipment, new capacities, new machines, etc., we could incremental grow with customers.

Sandeep Baid: And the margins they command will be far superior?

K. Srinivasan: Significantly better than the current margins.

Sandeep Baid: And my second question is with respect to electro minerals, Sridharan mentioned that this year on a consol basis we should be looking at a margin of about 12.5% to 13%. Last year we did close to 12%, on a standalone basis it was close to 6% which is what we are guiding for this year as well. But last year we had issues in Russia, this year those issues are out of the way, we have these new projects which have started contributing and these are higher margin products. So, guiding only for 12.5% when we did close to 12% last year, I just wanted to understand that why with Russia problem out of the way shouldn't it be better?

R. Sridharan: See, what I expect is that we will have a higher standalone sales, but almost flat PBIT margin, coupled with better performance in Russia will move us on almost 11.8% to 12.5%, so that is what we are expecting at this stage.

Sandeep Baid: The new projects will not really contribute much because the capacity utilization will be low there?

R. Sridharan: Yes, exactly. And incrementally we should start seeing it at least a year later.

Sandeep Baid: Right. And Sridharan, last question, in the catchment area of Maniyar, this year also the rains have been continuous?

R. Sridharan: Second year in row lower, and lower than the last year by at least 30%.

Moderator: Thank you. We have the next question from the line of Bhavesh Jain from Envision Capital. Please go ahead.

Bhavesh Jain: Sir, there was one recent article last month where you were talking about realignment strategy for the longer term over next five years. Can you please elaborate more on this? And any product where we are there in some advance stage which can click for us in near-term?

K. Srinivasan: I am not too sure how to answer this question, let me try. Basically we expect going forward that the newer businesses which is really addressing the newer industries like electric cars, like compass, etc., would be a larger part of our profile. And this is something which will evolve over a period of time, it is not going to happen in quarters. So, all the new developments that we are doing, for example, there are projects where we work on graphite. Graphite could be a key input material that will go into the batteries and again from batteries into all kind of other things, electric cars and whole lot of things. We work on the ceramic on special metalized products which are used in what is called as high voltage DC switches, today the metalized cylinder works on AC switching systems, transmission and distribution system. The new metalized product that we are trying to develop and work with would be on high current AC switch and DC switches which will be used in the charging of let's say the electric cars and other things, because you do not have these charging stations all over the world. So, we are doing a lot of work on what we think the world is going towards. And these are things that will come step-by-step. For me to put any kind of an exciting number and give you it could end up being misguiding. So, I would leave it saying that the companies are aware that there is a transmission from the world of being very metal centric to a non-metal centric world. And this is an evolving thing and all our new developments and R&D work is happening around this space. And it would be premature to make any major announcements in this, let it evolve.

Bhavesh Jain: And sir any update on this M&A strategy, because we were looking for some acquisition in US and in Europe?

K. Srinivasan: I think that again is a subject that we would allow it to evolve and happen. Intent is there, it is still not an event, we would have to make an announcement only when it is there.

Moderator: Thank you. We have the next question from the line of Shekhar Singh from Excelsior Capital. Please go ahead.

Shekhar Singh: Just a very basic question, on a consolidated basis can you tell what is the total capacity of the company in abrasives, ceramics and electro minerals?

R. Sridharan: It is very difficult one, I think domestic is about 26,000 tons in abrasives, in terms of outside of India is roughly about somewhere in the range of 15,000 tons in abrasives. In terms of electro minerals, again, silicon carbide 80,000 tons outside of India, domestic 5,000 tons, about 12,000 tons of brown fuse and 12,000 tons of white fuse alumina, Zirconia about kind of 5,000 tons, alumina Zirconia at 3,000 tons, semi-friable in the range of about 14,000 tons to 15,000 tons. And in terms of ceramics, we have about 1.1 million cylinders, will go up to 1.8 million cylinders. And in terms of the VAW ceramics 7,500 tons. By and large that is what we have as capacity. Refractories is in the range of about 25,000 tons in terms of the monolithic and about fines in the range of about 10,000 tons broadly**.** Coated is 18 million square meters overall, that is a broad capacity. I think it is difficult to take this and make any kind of a calculation, I would rather leave it like this. The current capacities can take us to a consolidated sale of anywhere between Rs. 3,200 crores to Rs. 3,500 crores with the new way of reporting with excise removed from the top.

Bhavesh Jain: And you said like you will be reaching Rs. 3,200 crores to Rs. 3,500 crores part of revenue in three years' time?

K. Srinivasan: Within three years, we hope to do better, let's see.

Moderator: Thank you. Well, that was the last question. I now hand the floor over to the management for their closing comments.

K. Srinivasan: All I can say is you have all been patient in seeing through a quarter for us also and this is the first time anybody has handled such a humongous change in the way business is being done in the country. It is not down and dusted yet, it is playing out. We have a certain outlook and our decisions are driven by the outlook that we take of how things are going to develop. We believe still a very positive outlook for the Indian economy as well as the business for us in India. We expect the three quarters upfront to get better and better and better. So, that is the closing comment I would leave you with.

Moderator: Thank you. Ladies and Gentlemen, on behalf of Kotak Securities Limited, we conclude today's conference. Thank you for joining us. You may now disconnect your lines. Thank you.