“Carborundum Universal Limited Q4 FY2019 Results Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to the Carborundum Universal Limited Q4 FY2019 Investors Conference Call, hosted by Axis Capital Limited. As a reminder, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Kashyap Pujara from Axis Capital Limited. Thank you and over to you Sir!

Kashyap Pujara: Good morning everyone. Thank you so much for standing by. It is a great pleasure to have with us the management of Carborundum Universal Limited to discuss the earnings for Q4 FY2019. From the management side we are represented by Mr. K. Srinivasan who is the Managing Director, Mr. Jagannathan Chakravarthi who is the Chief Financial Officer, Mr. Chandramouli who is, Senior GM Strategy. Without taking much time, I hand over the floor to Mr. Srinivasan. Over to you Sir!

K. Srinivasan: Good morning to all of you. As a practice, we will now have Mr. Chandramouli read out at least a few sentences of our disclaimer and then I will take the call.

G. Chandramouli: Good morning. During this call, we may make certain statements, which reflects our outlook for the future or which could be construed as a forward-looking statement. These statements are based on management's current expectations and are associated with uncertainties and risks more fully detailed in our annual report, which may cause the actual result to defer. Hence, these statements must be reviewed in conjunction with the risks that the company faces.

K. Srinivasan: Thank you Mouli. Thank you all. Good morning once again to all of you.

F2019 was a mixed year. H1 was exceptionally good and H2 was not so good. The consolidated net sales for the full year increased by 14% to Rs. 2656 Crores from Rs. 2330 Crores driven largely by good performance across all the major business segments.

At a standalone level, net sales were Rs. 1752 Crores compared to the last year's Rs. 1551 Crores, a growth of 13%. On a consolidated basis, profit before tax increased from Rs. 322 Crores to Rs. 369 Crores and at a standalone level, profit before tax increased to Rs. 248 Crores from Rs. 205 Crores, but more importantly Q4 was an exceptionally difficult quarter in many sense.

The normal demand buoyancy was absent. There was palpable uncertainty in terms of small businesses destocking in the domestic market. We believe this is largely due to existing account closure under the GST This I believe was largely coming out of the GST opening account closure business. In the overseas market, Europe was very quite and so to in the U.S. particularly in our businesses, with the overhang coming from the pre-stocking of the Chinese imports that was done to beat the 25% duty, which really never kicked in. With all this we chose to be prudent, did not push sales. The sales in Q4 at standalone was Rs. 448 Crores, which was 1% lower than the Q3 sales of Rs. 458 Crores.

I must add that in my memory in the last 15 - 20 years we have never had a Q4 lower than Q3. So this is exceptional; however, the PAT at Rs. 49 Crores was 40% higher than the Q3 PAT of Rs. 35 Crores. This is significantly due to the non-operating income of Rs. 8 Crores, this is practically a normal thing, because most of the interim dividends kick in the last quarter. So nothing unusual about it.

The consolidated sales was Rs. 695 Crores against Rs. 638 Crores of last year but PAT fell to Rs. 62 Crores against Rs. 66 Crores. We will cover why this happened and where it comes from.

Let me go to the segments. Abrasives at a consolidated level net sales for the year was Rs. 1124 Crores compared with the last year sales of Rs. 1018 Crores, a 10% growth. Standalone business grew by 8.7% from Rs. 847 Crores last year to Rs. 921 Crores. Continued growth in coated products, supported by launch of new products, helped us to get this growth. The market is relatively flat. The bonded business also grew during the course of the year largely on the customer account particularly in the first three quarters.

Business made a conscious effort to enter markets that were not serviced well earlier. I would like to update that we have gone ahead with the investment in the coated maker. This will start coming into play by October onwards during the year and this would make it one of the largest coated capacities in the world in any one location.

The abrasives sales in Russia was at a higher growth during this year on account of new products and deeper engagements. Sterling also had a reasonably good growth during the year.

The Electro-Minerals division at the consolidated level the sales was Rs. 1019 Crores compared to Rs. 883 Crores, which is a 15% growth. The standalone revenue increased to Rs. 453 Crores from Rs. 405 Crores during the year a growth of 12%. Business did establish new products like synthetic alumina but we were deeply impacted by lower sales in Zirconia products both in India as well as in South Africa.

Fused aluminum oxide business of the company registered a moderate growth, in both the domestic and the international markets. The fine powder business, which today is largely for the diesel particulate filter had a dramatic decline in the last two quarters. It continues to struggle because of the diesel car production has also come down across the world.

The demand for semiconductor application was stable for microgrit. For the first time, we had lower offtake of high crystalline, high purity materials from Volzhsky going into the DPR applications both in Europe and in India. Consequently, the profit margin in Russia also declined during the last quarter.

In South Africa, the Foskor Zirconia business produced 784 tons for the quarter, which was some kind of a record. They have recovered from the last two three quarters giving us a ray of hope that things could get better; however, our share of the loss for the year was Rs. 12.6 Crores, which is significant and so the board would have to take a decision going forward how we would deal with it.

The Maniyar plant was put back. Two of the turbines were operational. The third turbine is being commissioned as we talk, but the rains have been so moderate and we would know how it pans out during the monsoon season starting June.

Ceramic Business: For the full year the consolidated sales were higher by 20% growing from Rs. 502 Crores to Rs. 604 Crores. We had a good year in ceramics both verticals of refractories and industrial ceramics going well. Standalone business grew from Rs. 401 Crores to Rs. 498 Crores, a growth of 24%. This was all round, metallized cylinders, wear ceramics all of them had significant growth. The profit margins continued to be stressed because of higher input costs both in aluminas as well as for the fuel.

The new metallized cylinder manufacturing facility line shifted from NTK Japan is commissioned and the overall capacity this year was at 1.5 million cylinders. Last year also saw the successful commissioning of the pilot air crafting plant as well as the spattering facilities and this is being setup primarily to service the aerospace industries.

CAPL Australia registered a 15% growth and Volzhsky's Ceramics, which largely supplies to NbSiC refractories for their aluminium industries also did well.

Capex; We spent Rs. 97 Crores on a consolidated level, out of this Rs. 54 Crores was done on the standalone and Rs. 36 Crores at Volzhsky. Volzhsky was primarily to increase our fusion capacities taking it up to 90000 tons along with a new substation, which would allow us to stabilize our power input costs going forward. The R&D continued to work hard and we had more than 20 IP filings during the last year.

Coming to the outlook for 2019-2020 we had significant uncertainties in Q4. Like I mentioned it was an exceptionally difficult quarter in many respects, the company chose to be prudent in terms of not pushing sales. Our receivables continued to be very, very strong. We have a lower number of DSOs than ever. We believe that Q1 also would be muted, and we would have to look at how things move from Q2 onwards. The demand continues to be flat overall in all the markets.

With this we expect that our turnover would definitely be above Rs. 3000 Crores and the EBIT margin would stay at the current level if not slightly better.

Now I would request Jagan to take it forward on the financials.

Jagannathan C: Thank you Sir. Good morning everyone. Let me now summarize the financial performance. The consolidated net sales for the year increased by Rs. 325 Crores which is 14% growth over last year, and PBIT grew by Rs.42 Crores which is about 13% growth. Out of the increase in sales of Rs. 325 Crores standalone share is Rs. 201 Crores. Our Russian subsidiary contributed Rs. 64 Crores to the increase.

The PBIT percentage to sales remained at 13% (excluding equity accounted investments) and 14% (including equity accounted investments). Standalone PBIT growth of Rs. 42 Crores came by way of higher volumes despite increase in operating costs.

On a consolidated basis, our PAT was Rs. 248 Crores as compared to Rs. 216 Crores earned during the last year. At standalone level, profit after tax increased from Rs. 143 Crores to Rs. 166 Crores. At consolidated level, PAT margins remained at 9.3% and at standalone level, it increased marginally from 9.2% to 9.5% aided by the operational efficiencies and recommencement of operations at Maniyar and SEDCO power plants.

Now the segment wise update; Abrasives at a consolidated level, PBIT increased by 6% from Rs. 132 Crores to Rs. 140 Crores. The incremental profit of Rs. 7 Crores came by way of standalone performance on the back of higher volumes and better product mix.

Electro Minerals division; Consolidated Electro Mineral business recorded a PBIT of Rs. 128 Crores against Rs. 127 Crores in the previous year. CUMI's standalone EMD PBIT growth of Rs. 12 Crores on the back of higher sales and volume. The net sales of Russian subsidiary grew by 16% but the profits were almost same due to adverse impact of exchange fluctuations. This exchange fluctuation was between Rouble and Euro.

PBIT was adversely impacted to the extent of Foskor Zirconia Limited losses, owing to lower topline and consequential higher fixed costs.

Ceramics: Ceramics had Rs.32 Crores increase in PBIT with a growth of 43% from Rs. 76 Crores in the previous year to Rs. 108 Crores in the current year. CUMI's standalone contributed Rs.28 Crores of gains owing to better volumes from both industrial ceramics division and super refractory division.

VAW's refractory business and CAPL contributed to the rest of the gains.

The debt equity ratio of the company as on 31st March 2019 is almost at nil, which was same in the last year. The total debt on standalone basis decreased from Rs. 1.81 Crores in March 2018 to 0.96 Crores on March 2019. On a consolidated basis, debt equity ratio improved from 0.08 as on March 2018 to 0.06 on March 2019. The total debt on consolidated basis was Rs. 97 Crores on March 31, 2019. This has come against Rs. 99.19 Crores as on December 31, 2018.

Movement of loan position at the end of Q4 2018-2019 in comparison to the position as on Q3 2018-2019, the Sterling Abrasives borrowings have come down by Rs. 1.15 Crores. CUMI India, it has come down by Rs. 91 lakhs and others, it has come down by Rs. 10 lakhs. Out of the above, the debt Rs. 96 Crores amounted to debts in subsidiaries and JVs.

Regarding the forex cover, CUMI typically is a net importer in dollar and net exporter in Euro and we take the cover as appropriate to cover the net exposure as per the forex policy. We have hedged USD 1.31 million to cover the USD exposure net payables of Q4 2018-2019.

Generally, our net position is minimal because our exports and imports are almost at similar level in both the currencies.

Outlook for 2019-2020 in continuation with MD's comment regarding the upcoming quarter, due to the market uncertainties we expect some impact on the volumes; however, we are very confident that the profitability will remain at the same level or may improve in the coming quarters.

Update on final dividends, the Board of Directors of the Company at its meeting held on April 26, 2019 has recommended a final dividend of Rs.1.25 per share, which is 125% on the face value of Re.1 to the shareholders of the company. The Company had earlier paid an interim dividend of Rs.1.50 paise per share. The total dividend for the current year is Rs.2.75 per share, which is about 275% of the face value of the share. Last year, we paid around 225% for the whole year.

With this, I conclude my comments and handover for the questions. Thank you.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Bhalchandra Shinde from Anand Rathi. Please go ahead.

Bhalchandra Shinde: Good morning. I would like to ask you about Foskor Zirconia, as mentioned in notes that there has been concerns raised by auditors about whether its ability to continue as a going concern. What will be our future action on Foskor Zirconia, if it continues to draw such losses?

K. Srinivasan: Bhala, the position is like this, actually this business though it is showing improvement from what it used to be at the last quarter we almost came to less than a 4 million Rand loss. It simply is not producing the volumes to justify the fixed cost. The problem there we have is, we are in a partnership with a state owned enterprise and they would have to agree with the way forward. Either eventually this would have to go into a state owned enterprise in their own fold, in which Carborundum would exit or we would jointly have to find a way to find the closure for this business. It is still work-in-progress. We would have to take a decision during this quarter. In any case, ample measure of caution, we have written down that investment in Consol CIL and I think that is why the auditors note say that there would not be a significant impact coming out of the decision either which way it happens in Q1.

Bhalchandra Shinde: Okay, so we have already provided, so not much impact will be there?

K. Srinivasan: That is right. That is what has been called out by the auditors.

Bhalchandra Shinde: Sir in ceramics we have really continued to show very strong growth largely because of the Australian mining activities and metallized cylinders. So do we expect this kind of a strong growth to continue, or it will moderate over the next one year?

K. Srinivasan: There are two parts to this growth. What you see as a ceramic vertical, it has the refractory part as well as the industrial ceramics. The industrial ceramics part has had a good year. They have grown by more than 20%-odd and the visibility what we have is they will continue to grow at this pace even during the course of this year. Because the order flow in terms of cylinders coming in, the order flow in terms of what is coming to the wear ceramics going into mining etc., is still very strong. The challenge we are having and that is what actually also we could see in the last quarter is, there has been a huge increase in raw material prices particularly high-grade alumina prices as well as energy prices since we have running contracts, our ability to immediately put up prices to correct this has been a challenge. We are going to be careful in terms of pushing our prices more, rather than to get the volumes. So first two quarters I expect that we have to get back to the margins and then we will get the volumes as well.

Bhalchandra Shinde: Sir, in Electro Minerals also as you mentioned that turbines are going to start, so will it improve our power cost and relatively margins? Or, because of the silicon carbide prices we will see a margin pressure there also?

K. Srinivasan: Two separate questions and two separate answers. The power cost went up to almost Rs.6 per unit effective for the last quarter; Q3 came down to Rs.5.7 in Q4 largely because we had some power generation that started during the course of Q4. We expect Q1 to be reasonably good, though the biggest power months are going to be actually June onwards, so you will only have a marginal effect in this, so at least it will stay at about Rs.5.5, Rs.5.7. So, there will be a marginal positive impact in Q1 but Q2 onwards the power impact would be good. As far as the SiC prices are concerned, the SiC prices are moderated largely because of the DPF story world over. The diesel particulate filter story is going exactly the way micros have gone, demands have dramatically come down and consequently the demand for raw silicon carbide crystalline has also come down. It would probably take two quarters before the balancing out happens. You must also keep in mind major capacities of silicon carbide have actually gone out in South America. Consequently, we expect this correction to be very quick. So, we should get back to good pricing even as early as in the second half of Q1.

Bhalchandra Shinde: Last question, if you can tell in FY2020 how much we are targeting for sales and profitability?

K. Srinivasan: I think we gave a broad number that we expect to do more than Rs. 3000 Crores at an overall consolidated and we believe that our profit expectation also around Rs. 300 crores plus PAT is what we have been putting out as guidance. There is no reason to correct anything. We have been hurt in Q4, but I believe if something has hurt us it will kill many of the others, we do get to look at international businesses and we realize the other companies have been even more dramatic consequently the recovery for Carborundum should happen even in the second half of Q1. And that would be pretty fast as well.

Bhalchandra Shinde: I will come back to further questions. Thank you.

Moderator: Thank you, very much. The next question is from the line of Fatema Pacha from ICICI Prudential Life Insurance. Please go ahead.

Fatema Pacha: Good morning Sir. Sir, I would like to understand is when we met sometime in Q3 and Q2 the conversations were around price hikes and how the margin trajectory will only improve QoQ, right. What we are seeing is that abrasives margins are falling despite I think there is not much cost pressures sequentially and ceramics margins were doing well that also has collapsed sequentially, so what has caused this big collapse sequentially in both abrasives and ceramics?

K. Srinivasan: I think the abrasives margin has not collapsed really. It has sort of flattened out. It is more or less at the same level as last year. It has not grown as much as we would have expected it. What really has hurt is the volumes. I mean the volumes have just come. Q4 generally, you would expect to at least be 15% to 20% higher than Q3. We were for the first time having a Q4 volume which is actually negative to Q3. And, this has happened not just at the standalone, it has happened in all the subsidiary, Wendt, Sterling, and all of them and this has really added to the overall consolidated margins looking smaller. It is really coming out of volumes. If volumes have been at a level what normally, Q4s are we should have been at a much higher margin than before. We obviously are not able to put up prices.

Fatema Pacha: I think your standalone margins you are saying are okay, but the consolidated margins are dropping and your international margins have dropped?

K. Srinivasan: Consolidated includes Sterling, Wendt as well as the international business.

Fatema Pacha: Fair enough, because abrasive margins I can see is down from 13.9 last year to 11.5, which is a massive drop.

K. Srinivasan: I will give you the margins on a standalone basis. The standalone margins actually compared to Q3 is actually marginally higher. The EBITDA margins is about 1.5% lower than Q3. It is still coming out of volumes; you see the volumes have actually gone down by about 2%.

Fatema Pacha: Sir and ceramics?

K. Srinivasan: Ceramics I just explained to them that we still not had the price correction to cover the cost increases that we have had on both raw material and energy cost. We are still running contracts and we hope to correct it by Q1 second half onwards.

Fatema Pacha: Sir but the Q3 margins are 18.5% and you have reported 14.5% in Q4. That is a 400 bps drop QoQ?

K. Srinivasan: Let me split that up. You are still in consolidated or standalone?

Fatema Pacha: Consolidated Sir.

K. Srinivasan: Consolidated ceramics actually I see that the margins are down largely coming out of lower margins both in standalone as well as lower margins flowing in from all the other subsidiaries, Volzhsky, CACL, etc.

Fatema Pacha: So all the subsidiaries have dragged on Q4 much more than standalone has?

K. Srinivasan: Which is also normally what happens. What happens is normally the standalone have a significant Q4 that it carries the subsidiaries. Subsidiaries Q4 for them is Q1, really a two and a half months' quarter. So, it is not really coming out of any fundamental change. If you see historically the Q4 for the international subsidiaries is generally not the best quarter for them, but the standalone is such a big number that it naturally carries everything else. So the big problem has actually been on the standalone.

Fatema Pacha: Okay, you do not think the internationally maybe Europe be a year of much slowdown worries?

K. Srinivasan: I just explained that there has been a slowdown in Europe, there is a significant lower offtake in Q4 in the US. I did explain in the opening comments that one, US has seen lot of material particularly on the mineral, ceramics, etc., expecting the 25% duty on Chinese imports to kick in. It has not so far. And Europe has definitely slowed down. Sectorally, DPF has hurt in mineral business, but overall I do not think there is any fundamental structural change that has happened that will make everything go down. We expect to cover it by second half of Q1.

Fatema Pacha: Sir, is there any link between when abrasives and ceramics margins went down, you are having EMD rebound, so is there some contra on the margin between these two segments per se like because EMD market?

K. Srinivasan: In a way, you are right because the EMD supplies into abrasives, refractories, etc. It is a question of how soon they can put up prices.

Fatema Pacha: Has that improved? Is the pricing power there improved?

K. Srinivasan: We have gone down so low in the Electro Minerals business but they are getting the impact of whatever price corrections they have started putting up, it still has to come in. In Maniyar, power went down. I explained in the beginning that because two turbines are back again, the effective power cost has come down from Rs.6 a unit to Rs.5.7. So, that has also contributed to the profitability in the Electro Minerals division.

Fatema Pacha: Yet would you say price hike is a big driver there?

K. Srinivasan: It is helping.

Fatema Pacha: Sir, what I want to know is that when your EMD price hikes have happened, is it this about the time your abrasives and ceramics price hikes will happen or not really?

K. Srinivasan: I think we are trying to put up prices. The challenge like I said is when volumes are so low, demand is so muted, the chance of getting a price increase is that much more difficult. Hopefully by Q1 we should start seeing prices going up.

Fatema Pacha: Sir in terms of end segment, I can understand auto is extremely slow, but when we talk about paint industry and other segments, they are yet doing very well in Q4 also. So what drags this growth suddenly because you have been doing consistently well in nine months, it has just fallen off the cliff in Q4?

K. Srinivasan: I really do not have a specific answer for that. I think it is a combination of a whole lot of things. We believe that the demand in the market was not there. I am not able to understand about the paint part of it. The demand slackening was all around in the consumer market, in the trade that was stocking up, and it was also a call. We decided that we would not oversell. As I mentioned in the beginning our DSO rates are pretty low. It is a call. It is a business call.

Fatema Pacha: Sir, April is similar is what you are saying?

K. Srinivasan: April is also going to be slow. I do not think we are going to see till the second half of Q1, there is going to be slowness in the market.

Fatema Pacha: Sir, you are hoping post elections things to normalize?

K. Srinivasan: We all hope, right?

Fatema Pacha: Fair enough Sir. All the best. Is it fair that Q2 will be better? At least you have some visibility on that? Or is it just a hope?

K. Srinivasan: I think as far as the longer-term contracts in ceramics, or in Electro Minerals we see a fairly good Q1 order backlog itself. So the trade is what we all worry about in terms of consumption which is really the abrasives that go into the trade, etc., we expect even that will pick up from the second half of Q1.

Fatema Pacha: Thank you so much.

Moderator: Thank you very much. The next question is from the line of Ujwal Shah from Quest Investment. Please go ahead.

Ujwal Shah: Thank you Sir for taking my question. Coming back to the guidance that you have provided, can you briefly touch upon the three segments and which one would really drive this and your thoughts on abrasives business because we have been hoping for this business to deliver, but due to GST or multiple reasons it has not really on the way we hoped for?

K. Srinivasan: Thanks Ujwal. I think the guidance largely is we are looking at definitely above 15% growth in all the four verticals. We have taken a larger number than that. Out of the growth, like you rightly pointed out, abrasives still is 40% and abrasive growth is the one which in a way also is dependent more on the retail sales. I mean still about 70% of our products are available on retail counters and this is where any kind of a liquidity crisis or consumption going down impacts and generally like you all know that we tend to be a little more cautious than others. My DSO rate is still, my trade receivables is less than 30 days, so we generally tend to be exceptionally careful in terms of overselling because of two reasons;

one is any dealer or a distributor decides to go bad the materials that is available with him is discounted and sold. So it destroys the value for every other distributor or dealer in the market. So for us it is very, very important that we are careful about the material availability. We took a call to not push and we held on to that. I keep mentioning that my receivable days are the lowest and there is not too much of inventory out there in the market. This gives me the confidence that as soon as demand picks up, we would be the first of the block to push sales. We expect Q1 second half onwards to be good and that should consequently start translating into sales. All the verticals we are planning like as I said above 20%, abrasives at least 15% and above and we expect price correction also to come in as soon as the volumes start picking up.

Ujwal Shah: Sir, your thoughts on Volzhsky what kind of expectations we have from their business? Sir, power cost over there and we were also thinking of expanding this business further not in the same location, but somewhere else, how is that panning out?

K. Srinivasan: Volzhsky had a good quarter. They did almost 20000 tons of SIC which is on, again I have to point out their Christmas and New Year comes in January, so really it is a small quarter for them, 19980 tons' saleable material is a good production. They sold everything. We did see a change in the product mix, like I said the high value crystalline going to DPF has moved more towards metallurgical consequently margins have fallen. The power cost at 2.84 Rouble is the highest we have ever paid and I think it will stay at this level largely because there continues to be crux of repower that we pay for supplying of power to Far East as well as for Crimea. So consequently this is adding up to our costs. Petcoke prices have stabilized but it is stabilized at a fairly high level, like you know oil and petcoke prices seems to go at tandem in sequence. So consequently I think the costs have all gone up, product mix has been unfavorable. On a quarter-on-quarter Volzhsky's profit actually fell by almost about Rs. 4 Crores that has also added to my lower profits in the last quarter. We expect this will only get corrected over a period of time. It is continuing to be at this level because product mix is not going to change in a hurry and costs are also not going to change. Only when the demand picks up starts materializing can we put up prices aggressively. We expect to put up prices by Q2 by at least 5% to 6% by which time we will come back to the usual profitability.

Ujwal Shah: And in terms of growth for next year from Volzhsky and our turn to actually move to another destination or increase?

K. Srinivasan: We will not go to a new location. We will continue to grow at the current location. The investment and capex done during the last year, was primarily (1) to increase the capacity for the nitrate bonded silicon carbide, which will go from 3000 tons to 6000 tons, huge demand for this is in the aluminium industry. Consequent changes in the transformers, the power supply substations have all been done. We will push up the production of silicon carbide in the current location gradually towards 100000 tons. We will probably go to about 92000 to 94000 tons during this year and in the next year we will go towards 100000 tons, we will do it carefully. We will not overdo this.

Ujwal Shah: Lastly in terms of inventories, the inventory buildup was because of what you are saying that you chose not to over sell in the markets and we have the inventory ready for as and when the demand picks up, is that the right way to look at it?

K. Srinivasan: The overall inventory actually on a standalone declined by about Rs. 1.05 Crores during the last quarter, but significant part of increase is there from the finished goods side. It is not raw material or WIP. So there is a mixed change. Generally, we tend to have more WIP and raw material. This time we had more of finished goods and yes you understood it right when I said we will be able to sell this as soon as we have the pickup in demand. From Q1 second half I expect we will have inventories being diluted as we start selling it into the market.

Ujwal Shah: Lastly on ceramic margins we had a very strong nine months and 4Q the margins did decline. As you mentioned we might look at increasing the prices. What would be our margin guidance for ceramics?

K. Srinivasan: We will come back to the usual margin we were doing about 18+, we will get back there. I would not be too worried about it. Nothing has changed in the market. Our costs have to be passed on. Most of our contracts are proprietary. The challenge really is it is like I said in ceramics, it is a co-created product. We make the product along with our customer. We have to honor contracts and we expect to correct prices to reflect cost increases. It will be in place at least by Q2.

Moderator: Thank you. The next question is from the line of Ravi Swaminathan from Spark Capital Advisors. Please go ahead.

Ravi Swaminathan: Just wanted to know for the full year what was the kind of volume growth and value growth in the abrasives space that we had? And also if you can throw more colour on the coated maker investments that we are doing? If you could give more details on what is the addition in that capacity, how much investments we are doing there and why we are doing that?

Jagannathan C: To update you on, I will take the second question first. The coated investments we are investing about Rs. 60 to Rs. 70 Crores of investments we are doing. This will almost double our current coated capacities and this will be the largest capacity addition in single place in the world. This is expected to come by Q3 end or Q4 of this year. The value addition in abrasive business for the current year it has grown from Rs. 848 Crores to around Rs. 920 Crores about Rs. 70, 80 Crores of growth is there. It is about 9% year-on-year growth. On the profitability front, this closed at around 13.2% last year. The current year there is a drop in the profitability. This is majorly because of the increase in the cost particularly raw material cost has gone up, rest of the operating expenses continue to be at the same level.

Ravi Swaminathan: Sir, this 9% growth basically how much of it would be value and how much of it would be volume?

K. Srinivasan: Ravi, I would take it as most of it would be from our product mix, which should really include volume as well. Price increase would be less than 2 to 3% on an average.

Ravi Swaminathan: And this increase in coated capacity is because of the fact is coated is growing at a faster pace than bonded and you will be looking at quarter growth in this segment because of which we are doing for capex or is it like genuine regular capacity addition that we are doing?

K. Srinivasan: See, we have one maker and we are practically matched out. It can do roughly about 14 million square meters and we are almost matched out on that. So, any further growth would need to come in a step jump because we do not do incremental. So the next make out, give another 14 million square meters so the challenge really is how do you fill up 14 million square meter immediately. So what we are actually doing is, developing what is called as large jumbos which can be exported and converted in various markets. So work has already started on this and this is the way we will try and utilize the capacities that comes up because generally requirement is, let us say, goes in percentages but capacity when it comes it will come only in a step. So that is the reason we did delay it for almost a year and a half, but on longer-term, this would be required for the next phase of growth in the abrasive business and that is the reason why we have gone ahead with this maker.

Ravi Swaminathan: Sir, in terms of competition from Chinese and other smaller players, I mean, you and Grindwell, would be major dominant players so apart from this has there been a significant increase in competition from Chinese guys or is it like the same level that which we are seeing compared to the last year?

K. Srinivasan: The competition in abrasive business by and large remains the same. It is predominantly the two big players in the value for money segment which is the mixed segment. The two of us and a few European, American or Japanese suppliers in the premium high end and local small players as well as imports etc., at the bottom end of the pyramid, which are really the cheap and dirty products. There has been no major change in the competitive intensity or the kind of competition we face. What is happening over a period of time is that the lower end of the segment also is now being more and more addressed by the bigger players like us and others. Consequently, when you do more sale at the lower end margins seem to look under pressure. Really it is the market downtrading and going more and more towards the lower end and all of us are still competing there. So that is the reason sometimes when you say volume going up, I keep saying product mix changes really as certain level of downtrading happens, people tend to buy cheaper products and we also tend to sell that to cover up for volumes. These are lower margin products.

Moderator: Thank you. The next question is from the line of Bhoomika Nair from IDFC. Please go ahead.

Bhoomika Nair: Good morning Sir. Sir, just wanted to understand the ceramic segment a little better. If you could just touch upon what is the exact utilization in the fourth quarter and what are our plans going forward? Has there been any impact of any forex losses or anything which has impacted the margins apart from the raw material cost hikes that we saw in the quarter?

K. Srinivasan: Let me answer this question like this. Actually the volume of production, we are almost keeping about a lakh of cylinders, 1 to 1.1 lakh cylinders a month. So volume of cylinders is actually very near our full capacity. So there has not been any change, but the contracts for cylinders are signed annually. We are still supplying it at a price at which we are not making the kind of margins we need to make, simply because the energy cost as well as the specialty alumina prices has gone up. There was an exchange loss and the more significant part of the exchange loss was really in Q3 which we already covered. Q4 the exchange loss is less than a Crores of Rupees. This is really mark-to-market for the outstanding export business. This is only a notional loss. So that is not so significant. In IC the margin fall really comes from a certain level of product mix and prices not getting corrected. You would see this will change from Q1 onwards and it will be fully corrected before Q2. There is no structural change. There is no demand slackening so things are actually good in the ceramics part and that is reflected in terms of the overall sales growth as well. Refractories has had actually a very good year. They have grown the best among all the verticals. They are doing well. Their margins are better. So overall the ceramics vertical as we see would continue to do well, Q1, Q2, etc., so do not look Q4 as any indication of any impending change. This vertical will continue to do well and grow.

Bhoomika Nair: Basically I will be passing on the raw material price hikes, and margins should revert back to normalized level?

K. Srinivasan: Absolutely and here it is not a market driven price hike. These are all co-created products where we are the only suppliers for most of this to the customer. You have to be fair, you have to be transparent. It takes a quarter, but they will correct prices.

Bhoomika Nair: Sir, we should see the correction coming into 1Q itself or will it be more gradual?

K. Srinivasan: Q1 onwards and Q2 we will be fully corrected.

Bhoomika Nair: Sir, second on abrasives, if I remember correctly in the previous quarter, in the Q3 result, you had mentioned that you have taken price hikes and despite that we are seeing a margin correction. So has that led to a downtrading also which has impacted and if you can touch upon, while I understand that the demand itself was fairly weak, would you be able to touch upon how GST is impacting towards the organized players as was expected in that sense, if you can throw some light?

K. Srinivasan: See what has really happened in Q4 is lot of what we hear is hear say. It is not that nobody can write, that is exactly the reason why things happen. The general sense we get in the market is there was a huge amount of uncertainty because of the GST opening stock adjustment etc., and that returns etc., all had to be filed, corrected, closed from January onwards. Many of the trade decided that was not the time that they would like to have some inventory or stock with them. Consequently, we also were not keen to push material into the market because I was very worried that some of this price would eventually disappear and never come back to the market at all. If there are outstanding or claims are fairly high they would eventually disappear and the stocks would disappear as well. So that is the reason we chose not to push the market. GST is, we believe, a work-in-progress. Nobody has a clue of where eventually it will go. The more changes may lead to more action and more confusion for the business. The lesser it is better.

Bhoomika Nair: And if I can just lastly squeeze on EMD if you can touch upon how value added products have been moved as a percentage of sales, it usually was about 17% to 18% if I am not wrong and also some color on the new facilities that were commissioned at the end of FY2018, how they have panned out during the year including the Bubble plant?

K. Srinivasan: So let me touch the EMD story. EMD story has been very sketchy. Volumes on white, brown, alumina, Zirconia etc., are strong and the demand is strong. Silicon carbide globally the demand is strong, but there was a certain level of let us say moving from the premium crystalline grids going to DPF to more of metallurgical but I believe this adjustment will also happen in the next one quarter. The big change has been in Zirconia Bubble. We have not been able to sell out our capacity in Foskor consequently we decided to use the capacities that we have in India to white fused because the demand for white fused is good, we will see volumes coming up from Q1 and Q2 onwards. So the mineral business, the electrode price is behind us, the raw material price increase is behind us, we are moving on, we are putting up volume, or at least using up the volumes and getting the margins back. The setback of Maniyar power also will play out in the next couple of months and after that we should be back in good shape.

Moderator: Thank you. The next question is from the line of Kirti Jain from Sundaram Mutual Fund. Please go ahead.

Kirti Jain: Sir, you had earlier highlighted that GST issue impacted in the standalone abrasives. Sir was the secondary demand better than the primary demand in your view for the standalone abrasive space?

K. Srinivasan: I think the demand has remained muted in Q4. We can only judge like this. One is the direct customer accounts largely where the auto, auto-component definitely Q4 was muted, demand was lower. What we were selling into the trade is really we fill counters and the counters sell to the retailers. There demand was reasonable. I would not say as muted as in the auto-auto sector, but the challenge really was how many of these guys are going to remain after one quarter. If they decide that they would go bankrupt rather than to meet all their commitments, then your inventory will disappear with them. So really it is a question of trusting only a few guys and not filling up the counters to the extent that you will take a hit if something happens.

Kirti Jain: Thats it from my side.

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

Aditya Mongia: Good morning everyone. Most of the questions have been answered. I wanted to ask one question on the Electro Minerals space. Now this is a segment wherein margins have been quite volatile. What I wanted to get from you is that, have steps been taken in the recent past because of which you will see lesser amount of volatility happening in margins on the EMD side from hereon? And if you could also highlight what more needs to be done over here just to protect margin profile in the segment?

K. Srinivasan: I think Aditya, what we really are doing is to see that the volumes are relatively stable. I think that is the best we can try and do. But with the nature of the business, you tend to adjust prices and sell, but not allow the volumes to fall because you practically contract out your power, your raw materials, etc,. So in this business, by its very nature, the best of companies should aspire to have a cost position that will allow then to completely run out its full volume irrespective of the operating prices. So, take significant part of the Electro Minerals business which is you could call it commoditized would be really run volumes flat adjust prices and sell. That would be really 65% to 70% of our business. The 35% of the business is really the add on or the premium products where you co-created for customers and sell it at predictable good margins. Now only way your margins can get stable is to get this ratio changed. If you have more and more of the customized product then your volumes can change, but your margins would be stable, but this business by its very nature every company has to accept 65:35 or 80:20 kind of a break. Most times, we end up being 80:20. Our aspiration would be to get to a 65:35 so that the impact of margin change is less compared to what you are seeing today, but it is still work-in-progress. It will take probably another couple of years by which time you have more of the premium products, the high-end products coming in. Every time we aspired to get bigger in that space be it in the microgrit, be it in the DPF, it has also come up with its own challenge in terms of rapid technology change obliviating the requirement itself for such products. So it is a complex situation. The only way this can be derisked is to aspire to have some kind of a leg in the more developed part of the world, which will allow you to be more current in terms of the development that has been happening in the mineral space. This means you can aspire to be more and more the value added product manufacturer and go more towards the 65:35. We are working on it. Quite a few things are happening which are WIP; we will share with you as soon as this is on the ground. That is a long answer for a short question.

Moderator: Sir the line had got disconnected for the participant. We move on to the next question. The next question is from the line of Kunal Sheth from B&K Securities. Please go ahead.

Kunal Sheth: Good morning. Thank you for the opportunity. Sir, two questions; one is that usually in EMD how soon can we pass on our cost increase to the customers? Is it usually in a quarter or like abrasives usually it is very slow and calibrated?

K. Srinivasan: I can explain. There are two parts in EMD. One is relatively commoditized product, which is run by global pricing and the other one is co-created product, which we make for specific customers. In the first part, it is commoditized, market driven, that is where the volatility comes up and where price increases can be pretty quick depending how the market is moving. The second part is contract driven. Generally, it takes about six months to get a price increase.

Kunal Sheth: And Sir, secondly while we understand there are near term volatility in the market in abrasives, but generally, if you were to think slightly medium term about the abrasives, can we think about that segment can go up the value chain in terms of margins, as we sell more specialized in coated products or it purely depends on the market?

K. Srinivasan: You have to look at abrasives in a couple of segments. So we sell these premium, diamond and super abrasives under the Wendt brand, under the joint venture. We sell the agri interested products largely under the Sterling brand, so overall we try and address the abrasive market through the standalone and as well as through the joint ventures and subsidiaries. Generally, you can take it that price corrections are continuing to happen. Premium products happen in all the three, probably the super abrasive business has more premium products coming up that is why you will see the margins of the Wendt business are higher, but even the conventional abrasive business also will see improvements in margins going forward with newer products coming in using premium grains.

Kunal Sheth: Sir, what would be that percentage? What would the new products contribute to the overall abrasives sales as of now?

K. Srinivasan: What we define internally as new products is product developed during the year and the product developed in the last few years. So we say three-year sale of anything which has started new is seen as a new product. Generally, it is in single digit at the moment. We are hoping to get to about 15% over azz period of time.

Kunal Sheth: Thank you so much. That was really helpful.

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

Kashyap Pujara: Sir, I had a couple of questions. One is on the abrasive side, while you did mention that your target is to grow at 15% across each segment in the coming year, but specifically when we speak on abrasives, you have a situation where the coated line is coming in and we were maxed out in the current year. So that would it be fair to assume that that will be one of the key levers for growth because we would be able to grow much faster, had we had the capacity currently already on board. So I am just wondering whether it is simple enough to place the demand in the market or do you still expect that you will have to go and find export destinations or markets for these products? Second would be about the bonded side especially thin wheels the infra push which in generally we expect that post the lull of the elections maybe towards the second half, we will start seeing that coming back, would it kind of boost the thin wheel demand, which right now seems to be a bit weak?

K. Srinivasan: First in terms of coated, it would be a very difficult first year, as soon as the new maker comes in because as soon as you start the maker you will start getting almost a million square meters a month and if you go and dump all the million square meters the market operating price will go down dramatically. So we have to do it carefully. Some part of the products we will place it domestically, a significant part of it we hope to place it with convertors outside of India so that is the way we are planning so that we do not get into a big price war out here in the Indian market. As far as the bonded and thin wheel business is concerned, yes, the market has bottomed out, prices are so low that even the Chinese cannot supply these price now anymore. So it can only go up from here.

Kashyap Pujara: Fair. Specifically on your ceramics side, that segment, the segment too has the highest operating leverage for us and obviously despite higher topline growth we are not seeing bottomline expansion, which is quite contrary to what was the generally accepted understanding, now having said that you did mention that the key issue is in the IC side where the prices have not gone up. Basically refractories is doing fine, IC you are confident of taking price up, so essentially this situation is not structural and it is more like a short-term which will correct by Q2, is that a fair understanding?

K. Srinivasan: Absolutely right. In fact, you said it right because if you look at it, it is a very competitive business where we are doing exceptionally well. The margin as a percentage is not low. It has gone down about 4% in the last quarter. It is not structural. We will correct it within one quarter.

Kashyap Pujara: Fair. Lastly, on the EMD front specifically, you did mention in the previous calls that you have a Z-450 and graphene and all these things that are coming in, but you have your own cost pressures that are very visible in the current quarter. So overtime, what do you read margin expansion in EMD specifically? How do you read that situation panning out? Would margins in the interim still continue to be under pressure given that the prices are moderate and your costs are high or do you see that correction happen in this year itself?

K. Srinivasan: Kashyap, like I said in the beginning, I think we still are in the 80:20 situations where more than 80% of our business is still running on the commodity cycle and only 20% on the specialty. We win a few and we lose a few. We got DPF related grits etc., running or the microgrit these have all come down, so we are filling out with newer things. The Z-450 is still not scaling up as fast as we would have liked. The Japanese has started buying. A few customers in Europe are buying, but we need to get the volumes and that is what has actually hurting Foskor like hell. As far as the graphene it is right to play bet. It is 10 kilos a day. We just now started placing a few kilos here and there, so these are things that can become big in a couple of years going forward. It is right to play bet at this stage but the big change in EMD would happen only when we have some kind of an external help coming in to address the non-commoditized part of the business. Like I said it is WIP, we are working hard on it. The kind of strength that we have in the commoditized part can be very well complemented if we can pick up something that will help us on the more specialty part. Putting them together would make this an unassailable competitive advantage. We are working on it. I can only announce anything when it happens.

Kashyap Pujara: Sure. Lastly what was the impact on Rouble depreciation versus the Euro in the current quarter in terms of Rupees?

Jagannath C: Almost Rs.5 Crores.

Kashyap Pujara: Almost Rs.5 Crores.

Jagannath C: Correct.

Kashyap Pujara: Thank you. I will get back in the queue. Nirav, can you take up more questions please?

Moderator: Thank you very much. The next question is from the line of Srinath Krishnan from Accasia Partners. Please go ahead.

Srinath Krishnan: Good afternoon Sir. Just had one quick question on Volzhsky; if I look at the ROE of the business it has ranged from 7% to 12%, in the past calls you have mentioned that only 15% is for internal consumption and you maintain a Chinese fall. From this business is this what we can look at? Are these the target ROEs for the business or what would be the aspiration is one? Thank you.

K. Srinivasan: Volzhsky had a sale last year in Rupee terms 630 Crores and made a profit of roughly about Rs. 89 Crores. I think they have been delivering roughly about 14% post tax profit. I think this is probably what you can expect. It cannot get better than this. I am not too sure what ROE numbers you have looked at.

Srinath Krishnan: This was previous year.

K. Srinivasan: Previous year numbers are Rs. 565 Crores of sales delivering Rs. 90 Crores of profit approximately about 15% plus of post tax profit. I do not have an ROE number to comment. Generally, you can take it that in terms of a mineral business it has been fairly consistent over the last seven, eight years and probably has the highest profit ratio of this kind of a business anywhere in the world.

Srinath Krishnan: Thank you Sir.

Moderator: Thank you very much. The next question is from the line of Manish Goel from Enam Holding. Please go ahead.

Manish Goel: Very good morning Sir. Just to clarify on your guidance on the margins, did you mention that EBIT margins are likely to remain steady at 14.5%?

Jagannath C: Yes. EBIT margins will remain at this level. This we are not talking about the quarter-on-quarter scenario because quarter-on-quarter scenario depends upon the demand and the volume what we get also. For the whole year because of some cost benefits that are flowing through from our power plants plus the stability of prices of our raw materials we expect the profits to improve a little bit or remain at the same level.

Moderator: Thank you. The line for the participant got disconnected. We will move to the next question. The next is from the line of Ravi Swaminathan from Spark Capital Advisors. Please go ahead.

Ravi Swaminathan: Sir, it will be great if you can give the breakup of the ceramics and refractories division in terms of revenue? How much of it would be wear ceramics, how much of it would be technical and refractories? And if you can touch upon what are the efforts that we are taking to grow the individual segments there given the fact that we might be relatively smaller especially in the refractory business in India?

Jagannathan C: Ravi, the industrial ceramics will be about 60% and refractories will be about 40%. This is the broad number. Division wise, we do not generally share outside because this is a competitive business. We need to be careful on what we can share outside.

Ravi Swaminathan: If you can touch upon the growth drivers for this. For example, metallized cylinders are there any plans to increase it further capacity and how much capacity utilization we are running at currently and refractories also how we are planning to grow in terms of new customers, new segments, etc.?

K. Srinivasan: The metallized cylinder business in terms of the monthly requirement we are already hitting 1.1 to 1.2 lakhs cylinders. That is the full capacity for the two lines. We will look at adding interim step of getting another 50000 to 60000 cylinders during the course of the second half of the year. The required capex for that is being cleared. So effectively we will be what is called as two lines optimized to give you an effect of 2.5-line project that is already being cleared which should take us to roughly about 2 lakh cylinders a month at full capacity depending on the product mix. Driver for this is actually smart grids, power transmission lines and a whole lot of other things that is happening. If you look at the refractory business globally 70% of refractories runs with steel. In our case, we are less dependent on steel. We do more with carbon black, petrochemicals, cement and whole lot of other things. All indicators are good. We also deliver refractories for aluminum industries for Russia where we have a cost advantage so that is where we do a significant amount of our business out of Russia as well. So I think the lead indicators in this business again like I said, generally good, but what gives you a competitive advantage is in most cases we would be among the lowest cost producers. That will allow us to sell our capacities.

Ravi Swaminathan: Thank you.

Moderator: Thank you. Ladies and gentlemen the last question for today will be from the line of Aditya Mongia from Kotak Securities. Please go ahead.

Aditya Mongia: Sir, just on the abrasive segment, I recall our discussion sometime back where we were talking about at least on B2C part there being good liquidity and good consumer confidence, so things appear to have reversed in fourth quarter. I just want to check with you, do you see growth returning back in FY2020 on this part or would you want to be cautious on FY2020 on the abrasives part?

K. Srinivasan: The B2C is largely driven by auto, auto components industry. It was muted in Q4. We will have to wait at least one more quarter before we talk about it. It was extremely buoyant right from capex equipment buyers, everybody was buying for the first three quarters. Machine tool industry was running at record levels all over the country. Suddenly seems to have quietened on in Q4. Let us see how, Q1 so far the demand is still muted. Like I said, give us at least one quarter before we can put out a number. We are otherwise reasonably confident of this 15% plus growth because the general consumption has not fallen. We were only careful about stocking up the inventories, but otherwise general consumption remains reasonably good. So we need to find. Give us a quarter before the B2C can be better called out. Europe has definitely slowed down on B2C. US is still very strong. So overall I would be still confident of 15% plus.

Aditya Mongia: Thank you Sir. That was my question.

K. Srinivasan: Thank you Aditya. As usual you get the last word.

Moderator: Thank you very much. As there are no further questions, I will hand over the call to Mr. Kashyap Pujara closing comments.

Kashyap Pujara: Thank you every one for being on the call. Thank you Mr. Srinivasan and Mr. Jagan for answering all the questions. Look forward to meeting you soon.

K. Srinivasan: Thank you all.

Moderator: Thank you very much. On behalf of Axis Capital Limited that concludes today's conference. Thank you for joining us. You may now disconnect your lines.