"Carborundum Universal Limited Q2FY13 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Carborundum Universal Limited's Q2 FY'13 earnings conference call, hosted by Kotak Securities Limited. As a reminder, for the duration of this conference, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference call, please signal an operator by pressing "*" and then "0" on your touchtone telephone. Please note that this conference is being recorded. I would like to hand the conference to Mr. Jasdeep Walia from Kotak Securities. Thank you and over to you Sir.

Jasdeep Walia: Good afternoon everybody. On behalf of Kotak Institutional Equities, I welcome you all to the Q2 FY'13 earnings call of Carborundum Universal. From the company's management we have with us the Mr. K. Srinivasan-M.D, Mr. Sridharan Rangarajan- CFO, and Mr. Raja Mukherjee, DGM Internal Audit & Strategy.

I hand over the call to Mr. Srinivasan for opening comments. Over to you Sir.

K. Srinivasan: Thank you Jasdeep. Good afternoon to all of you. We start this conference with a good news that the cyclones that hit yesterday has sort of left the city unscathed and all of the plants are operating well and so it was not as bad as we expected it, because by yesterday the town was practically shut up, but I think it sort of let the city unharmed and we all come out of it pretty quickly.

We had a very difficult quarter, I must say. We expected to comeback in all our verticals, but it did not happen as expected. Q2 was only marginally better than Q1, which in turn was very marginally better than Q4 of last year. In the sense it was not as sharp a recovery from the trough that we hit in Q4 as we expected, so that is the concern for us. But having said, it I must also say that we are better than Q1. We expected to comeback very quickly but we did not but we are better than Q1 and I am going to explain how it is in terms of the business itself and what is that we are looking ahead and then later Sridhar will take you through the numbers.

On a sequential basis we crossed the 500 Crore mark on a consolidation once again. It was a 4% growth quarter-on-quarter basis. All numbers unfortunately will suffer for comparison because you must understand Q2 last year was an extraordinary quarter. It was a best quarter ever in the history of Carborundum. To that extent I have to make the caveat that the comparisons to that quarter is always going to be difficult but if you look against Q4, they look much better. On a standalone basis, the growth was 2% quarter-on-quarter basis to 283 Crores. At a consolidated level, on a sequential basis the sales grew by about 5% and on a standalone basis it grew by about 4.6%. So, there was top-line growth in standalone as well as consolidated on a sequential basis which I guess was important and thus it should be noted that the business is moving upwards. Overall, we delivered a profit before exceptional item of about 55 Crores. This is significantly lower than the previous year amount of 99 Crores but as I said that quarter was the best quarter ever.

I will take you to abrasives. At consolidated level the Q2 sales were 210 Crore versus 205 Crore, that was a marginal growth of 2.5%. On a sequential basis, we are about 4% better. In abrasives, I must say the domestic market continue to be under pressure in all the sectors, constructions, fabrications, steel, engineering and everyone in this business has suffered in India, so consequently off take was weak we are also very cautious in terms of seeing that we do not oversell and have the channel loaded because that is a very dangerous thing in downturn. So we continue to be very prudent in terms of pushing sales, we have collected the money that is important so we could not grow as fast as we expected to.

Russia also grew again marginally about 3% to 4% there again manufacturing activity is low. Sterling, which sells primarily to the abrasives for the agricultural products, recorded a good growth. They are at 21% growth, not so much because of the same product selling more, they introduced new products particularly for the rice finishing, and rice polishing and this took off very well so they grew by 21%. The other small piece in the abrasive business, which adds on is Wendt consolidation and Wendt India also did not do well, they also had a very weak sales during the quarter.

So, broadly in terms of abrasives, I would say it was a muted quarter marginally better than Q1 and as we look at going forward we expect things to get better and I will explain why we expect it to get better not in Q3 as much but definitely in Q4. Q3 traditionally, abrasives has always been a weak quarter because practically it is a 2.5 months quarter with both Dussehra and Diwali coming in so we do not expect a very significant improvement in Q3 but Q4 definitely we expect improvement.

On the Electro Mineral business this is a business where we expected the recovery to come in quickly and fast. You will know that Q2 of last year we delivered an extraordinary margin of about 28% on EBIT. Now this is going to suffer in comparison and also it suffers as a fact that this industry across the globe is today under deep stress. We did a sales 152 Crores net on consolidated level versus the 190 Crores so it is not a major drop on the top-line, sequential basis also there was a marginal growth about 0.9% but the big issue that we continue to have here is that a lot of the sales are at a bit lower margins and I will explain this going forward.

Foskor did sale much more in Q1 but they were all at a very, very low margin because we were still selling products produced with high cost inventory and to a market which was not willing to give us increase in price. In Volzhsky we maintained and grew the volume but we were under pressure in margin primarily coming out of the big jump in the energy cost. The electricity price in the quarter went up by almost 16% so margins were under pressure. The domestic business and the Electro Mineral business out of India sequentially grew by 6% but however there was a drop of 14% compared to the corresponding quarter last year. Last year, that quarter had a huge sale of micro grits for the photovoltaic and as you know the photovoltaic business has gone through a significant change with a major portion of the business moving out of Europe and America into China and Asia consequently our addressable market has dropped significantly. So that as an issue continues and we are trying to find a way to address this market in a more profitable manner going forward.

We did have a sale of micro grits out of our plants in Q2 but Q3 we are going to see how this can be maintained or alternatively try and see whether we can push up our sales of alumina and bauxite. On the Electro Mineral business, the margins remain under pressure. We do not expect it to comeback even in Q3 because the situations continue to be under stress in all our key markets and hopefully by Q4 you can see something improving. Primarily because there is still inventories available in the pipeline and they would have to disappear, new capacities are not coming up and several people have stopped fusion.

Ceramic business continue to do well. We were stressed out because we did have limited number of customer for the metalized cylinder business. We are trying to change it by addressing more number of customers even though the business per customer is not growing but with larger number of customers we seem to be getting better. The sales were at 133 Crores versus 117 Crores that is a 14% growth. On a sequential basis we grew by 13%. CUMI Australia grew again though the margins were under pressure because their sale into China primarily for coal washery business is under pressure in terms of margin but overall I would say the Ceramic business is doing well and will continue to do well.

The refractory business to an extent is impacted because of the project closures in India and we expect to see things get a little better from Q4. We do not expect it to be better in Q3 but Q4 hopefully we should get things better. The margins on the ceramic business overall continues to be strong. On a consolidated basis we are about 18.5% so the margins remain strong though there is small erosion which we explained, but overall this business continues to grow and continues to remain strong.

On the capex we said we will do about 200 Crores. We are using this downturn to try and see how we can what we call as discover factories within factories how do we get efficiencies improved, how do we do small automation to see whether new capacities can be unlocked, which can pay a lot of dividends. We have been careful in terms of the capex commitment but we expect that still we will go ahead with major planned capex's and we are likely to be ending up between 160 and 170 Crore of capex spent overall.

Key things that we would likely to sort of look at is to see whether we can defer Big furnace project in Russia by at least six months to eight months, primarily because see the silicon carbide prices are muted and the energy price in Russia did go up last quarter so we would like to sort of signal to the administration and others that we need to be competitive to add capacities. So overall we are committed to that but we would like to see whether we have to bring the capacity in earlier, so to that extent we will probably delay this by till six months.

That is broadly the outlook. Yes, it was a difficult quarter. Lot of very good work is happening. The team has been doing an excellent job in terms of using this downturn. Not to put the shoulders down but to actually see what is that we can do to become more competitive as we come out of this downturn. So, like I said one of the key things is happening across locations is what we call is discover factories within factories, which would mean the capex intensity of business going forward must comedown and we should be more competitive as we come out in this downturn. There are several things happening in many geographies I will touch it later, but overall yes, results are not inline with what we wanted or what we expected but it is not a scare in the sense as we sit in the business and talk about it there is 25% fall in profits and as we look at it is not as far from what we could have done, given the things that happened and compared particularly with that of outstanding Q2 of last year. Sridhar will explain with little more on the numbers which will give you a perspective then we will comeback and take your questions thank you. Sridhar.

Sridharan Rangarajan: Thank you Sir. Good afternoon to all of you. I think first of all my apologies that I believe that the consolidated numbers somehow was not posted in the site with appropriate time there was a mix up due to this cyclone, power went down, and there were issues with network. We tried to send you by yesterday night but I think today morning we sent to all of you, whenever we could have done as the first opportunity.

I think if you look at the numbers what we have as on Q2 profit from operations before other income, interest and exceptional we have grown at 5% compared to Q1 which is at a 60.2 Crores versus 57.4 Crores what we delivered in Q1. So fundamentally, I think what Mr. Srini said is that operationally we are getting better compared to Q4 to Q1 and Q1 to

Q2. At the same time, you have question on mind is that, we see that the 67 Crores drop in profit compared to the first half what we delivered versus the first half what we delivered today but I think I would say broadly explain why it happened and then we will go into the detail.

First of the 67 Crores drop power and fuel impact alone amounted to 17.7 Crores, which consisted power increase in Tamil Nadu, Kerala and Russia put together . Second, we had the first half of last year with exceptionally good micro grit business, that micro grit business has gone away and we are doing lower than what we did that costed as about 12 Crores. Then, we have Foskor where we talked about cost push is higher than what we can get us price that is about almost 12 Crores. We acquired a new business in Thukela, which is a refractory and mineral business which had an operation of two months, which had a loss of 6.6 Crores. So, if you look at that, all these are externalized and beyond our normal control that is what we had and I will definitely explain what happened in Thukela when it comes to an appropriate time and besides this coupled with volume drop in abrasives and refractory that is about 13 Crores and a cost push that we could not pass on compared to whatever we had in terms of foreign exchange impact etc., include raw material that is about 6 Crores. That kind of broad outlines the reasons for variance.

Now let me get into the detail, I will say that first of all the consolidated level, we registered a sales growth of 20 Crores, which is at 4% growth compared to the corresponding quarter last year. The entire 4% came from translation gains and the export exchanges converted into the current exchange rates. Incremental sales of 20 Crores resulted in a drop of operating PBT at 44 Crores. Out of this 20 Crores and a decrease of 44 Crores of operating PBT, CUMI standalone contributed to 5 Crores of sales and decrease of about 18 Crores of operating PBT and subsidiaries and JVs put together contributed a 13 Crores increase of sales and a decrease of 26 Crores of operating PBT.

CUMI standalone operating PBTs percentage dropped from 18.7% in Q2 versus to 11.8% of the current Q2. This drop came by way of rising input cost in a challenging market making it different for us to take the adequate price increase. On a sequential basis, the margin fell by about 4.6 Crores or 230 basis points. On a quarter-on-quarter basis standalone margin dropped at about 18 Crores. This happened due to the following reasons:

One is adverse product mix mainly coming from the SIC sales that is about 7 Crores, lower volumes mainly coming out of the abrasive that is about 4 Crores, higher power cost and fuel cost mainly coming out of tariff which is about 6 Crores, abrasive cost push work versus the price increase that is about 1 Crore. On a sequential basis, the profit dropped by

Rs.4.6 Crores or 230 basis points mainly due to power and fuel again about 1 Crore, exchange loss about 2.6 Crores, salary increases and other cost increases normally our salary get revised in this quarter that is about 2 Crores, lower nonoperating income largely out of the dividends we had Q1 dividend about 7.5 Crores. These are normally timing issues and it does happen every quarter so it is swing of about 7.5 Crores. This was offset by a higher volume as well as the price increase that we could get in that quarter of about 9 Crores so by and large I would say definitely on a Q2 overall basis we had higher volume higher price that gave us as about 9 Crores. Of course we had these 7.5 Crores of higher dividend that we had last quarter which would not recur this one but for that we would have delivered far higher numbers compared to Q1.

On a half yearly basis, standalone profits were down by about 33 Crores at 650 basis points largely due to lower volumes and cost push versus price increase mainly abrasive is about 10 Crores, adverse impact on product mix again coming on the SIC space which is about 12 Crores and higher power and fuel cost at about 10.7 Crores.

Now moving to consolidated number as far as the PBT margin is concerned, on a quarter-on-quarter basis it typically mirrored what we had in standalone. There is a drop of 44 Crore or 920 basis points, apparent due to the following; one is we just saw what happened in standalone that is about 18 Crores. VAW had an impact which is about 8 Crores of adverse exchange movement basically the gain what they had in last year 2nd quarter versus the small loss what they had in the current quarter and you should appreciate that the Ruble started appreciating against the dollar at least about close to 10% in the first half and about 6 Crores in the power cost increase these are the two reasons which lead to overall impact of Rs. 14 cr. Foskor Zirconia was typically impacted by lower margin on account of uncertain market condition. We could not pass on the price increase and the results of unwinding of the inventory carried at the higher cost of about 5 Crores. Loss of Thukela refractory is about 6.6 Crores and out of this 6.6 Crores close to about 4 Crores was one time arising out of the inventory the revaluation. I would like to say that the company that we acquired was a captive company of RHI so their method of valuation of inventory is different to us. We had to value the inventory as per our market value which are addressed, while they were valuing at pretty much on standard cost basis, and because of that we needed to write down up 4 Crores.

I would also like to say that we have acquired this company at a significant discount than book value what we had. So, we expected the losses at the time of purchase itself so we expect that it will take about six months before we can revise this operation and bring to a normal stage.

On a sequential basis there was a drop of 2 Crores which is 90 basis points which happened due to the loss of Thukela, which is 6.6 Crores plus loss of Rs. 1.3 crore arising from other subsidiaries and Joint ventures, offset by standalone gain of 2.3 Crores and Foskors lower loss compared to the Q1 which is about 3.6 Crores. On a half yearly basis, basically the first half versus the first half at a consol level, we had a 67 Crore drop which I explained at the start.

Moving to the segment, the abrasives PBIT margin moved from 14.8% in Q2 of 2011-2012 to 10.8% in Q2 of 2012-2013, this largely coming out of standalone, which consisted of more than 75% on the consolidated sales. Standalone abrasive margins dropped from 18.2% to 13% basically a drop of 7.5 Crores owing to lower volume and cost push on raw material, ability to pass in a tough market situation that is about 6.5 Crores, higher power and fuel cost increase is about 1 Crores.

On a consolidated level, drop of 7.6 Crores margin for the quarter mainly due to abrasive's standalone. On a sequential basis, the margin dropped by 1 Crore, primarily due to the cost push of raw material and a foreign exchange adverse impact on the import what we had for abrasives.

Moving to Electro-Minerals PBIT margin of EMD moved from 28.9%, which is the best ever quarter in 2011-2012 to 10.5% in 2012-2013. Compared to Q1 12-13 margin, the Q2 12-13 margins were lower by 40 bps drop. As Mr. Srinivasan, mentioned Q2 of the last year was the best performing quarter for EMD. In the last quarter we mentioned that the normalized margin for this division would be 14% to 15% to such time we bring the external challenges under control. We have mentioned there were one offs in Q4 2011-2012 and Q1 2012-2013, in the form of inventory devaluation for Electro-Mineral Division and reinstatement loss in Foskor loan, which lead the margin to fall to 11% level. In this quarter the major impact came out of Thukela Refractory at 6.3 Crores. If you gross this up it would mean a margin of EMD would be in the range of 14.5%. As mentioned, in the last earnings call, we continue to face challenges on the following fronts, photovoltaic market, global cooling of price, volume reduction in SIC micro grits. All these are continuing. There is some amount of risk that is expected out of inventory devaluation arising out of micro-grits inventories that we carry and unwinding of Zirconia that we carry because of the high input cost.

As far as ceramic segment is concerned, PBIT margin of ceramics moved from 22.9% in 2011-2012 to 18.5% in 2012-2013. On a sequential basis, there was a drop of 240 basis points. Australia is witnessing pricing pressure due to Chinese competition, coupled with forex losses, the margins were marginally lower. Domestic market in refractory is seeing some challenges since projects are getting postponed. Sales of refractory business were lower both on quarter on quarter basis and sequential basis and margins were under pressure owing to volume drop.

As far as the capex, the total capex spend so far is about 94 Crores. This consisted of 27 Crores on a standalone basis and about 67 Crores on the rest of the subsidiaries, mainly coming out of the Foskor expansion. All our programs are intact except the possible postponement of SIC capacity which is inline with the existing SIC e demand . We will review the capex plan in line with business as we go about. As far as debt to equity ratio on a standalone basis the debt equity ratio had decreased from 0.25 as of June 2012 to 0.30 as of September 2012. The debt on standalone basis increased from 164 Crores to 207 Crores, largely to fund the working capital. On a consolidated basis, the debt to equity ratio decreased from 0.46 as of June 2012 to 0.49 as of September 2012. The debt on consolidated basis increased from 448 Crores to 489 Crores, largely coming from the standalone increase.

So, with that I would say broadly if you look at it, the challenges can be put into buckets like structural issues, operational challenges and market related challenges. I would say as far as operational issues goes, typical cost management which is managing input cost, both in terms import of raw material plus power and fuel costs. As far as the market related challenges are concerned, typically lower volumes and project delays that are facing in various segments that we have. As far as the structural issue goes, the SiC micro capacity, which Srinivasan touched about is the challenge that we will have to address them in the coming quarters. As of now it seems that it would be a minimum about year to year-and-half problem that and we would like to address that, but we are quite confident we would find a solution to that and would come out of that. So with that I think we will open up for question and answer session.

Moderator: Thank you very much Sir. Ladies and gentlemen, we will now begin the question and answer session. We have a first question from Lakshmi Narayanan of Catamaran Ventures. Please go ahead.

Lakshmi Narayanan: Good evening Sir. My question is on your Russia capacity of Electro-Minerals. What percentage of the capacity has been utilized and what are the internal sales versus external sales of Russia? Second, in Russia, you mentioned there is a power increase that has taken place. Do you see this is the one off thing or going forward to be some kind of sustained power increase?

K. Srinivasan: In terms of capacity utilization, we produced approximately about 6200 tonnes a month and we are continuing to produce flat. You have changed product mix, but till H1 we have run at flat. We are probably going to slow down a little bit in Q3, which is really the last quarter for them, we will go a little slow may be in this quarter, but otherwise so far we are running 100 plus in terms of capacity. The reason we want to slowdown a little bit is to send a message out that this power price it is not viable or at least it does not make that much of sense to produce flat out if we have power price increase. We have a 16% power increase that has come up. It was far, far more than anybody expected. There has been industry representation. There have been particularly complaints that have gone from the high energy consuming industry also. The government is looking into it. We do not think it is a sustainable basis that this power hike should stay, but we must plan that we may not have a full benefit coming back in Q3, but we hope that this price increase is at least partially rolled back. That is why also we are trying to send out a message that we will delay the big furnace and have a relook at it with this kind of price increase.

Lakshmi Narayanan: Sir, from the Electro-Mineral front, can you just help me to understand the capacity of Electro-Minerals in India, in South Africa and in Russia? Also what percentage of that Electro-Minerals, which you actually produce last quarter you actually so consumed internally and if you export or you sent out of your factory?

K. Srinivasan: Quickly, in terms of capacity in India, we roughly do about 10000 tonnes of silicon carbide. We roughly do about 17,000 tonnes of alumina and about 5000 tonnes of specialty, so that is the capacity as far as Electro Minerals are concerned. In South Africa we have two fusion capacities now. In Foskor we do roughly about 4000 tonnes of Zirconia which is what is Calcia Stabilised Zirconia. Of course, it is being stepped up between new plants coming up at Isithebe Plant which will be RHI Isithebe base Plant. We have a capacity of about 20,000 tonnes for year of various aluminas. This is broadly our capacity and in Russia roughly about 75,000 tonnes of silicon carbide.

Lakshmi Narayanan: Within this what is consumed internally and what is sent outside?

K. Srinivasan: At the moment, in the last two quarters out of Russia, we are consuming roughly about 15% internally. Internally means it includes what we consume in Russia itself and what we consume within the Carborundum System. As far as India is concerned very roughly we consume about 10000 tonnes internally.

Lakshmi Narayanan: Who are the consumers of this someone like Saint-Gobain is the consumer?

K. Srinivasan: Saint-Gobain is also a competitor and also a consumer. We sell to all the abrasives, refractory, ceramic companies in the world and we also sell to the steel producers for the metallurgical grit.

Lakshmi Narayanan: This is helpful Sir. I will come back in queue if I have other questions.

Moderator: Thank you very much. The next question is from Mr. Jasdeep Walia of Kotak Securities. Please go ahead.

Jasdeep Walia: Sir, in the light of 16% increase in power cost, let us say the government does not reduce power prices. So, what would be your perspective then on capacity expansion and viability of Russian operations?

K. Srinivasan: There are two answers in this. First is clearly, we do not like this increase, that is for sure. Second is this increase is not being done by the government per se it is done by combined processes of two things. One is that, there is power generating organization and then there is a power distribution company. In some reorganization, an unintended consequence was that merging these two meant that they together put up the price by 16%; I think there is a huge amount of outcry and representation that has gone out. It would be too early to predict for a country like Russia to immediately take a view that this is how it is going to be. Let us give a quarter's time. Nobody expected such increase and we do not believe this is sustainable. If it is hurting us, the other company which produce aluminum and other things will be severely hurt. I do not think this kind of a thing is sustainable or good for the industry as a whole. So at the moment the message we are sending out is this is a reality, this is the increase. This is an increase that has been taken. We are flying our message based on that we will defer our expansion, but even at this increased rate we are profitable that I can assure you. We are profitable you see the numbers, Sridhar will share you the numbers, but we do not like this increase because it means that we become lesser profitable and less competitive in terms of expanding capacities.

Jasdeep Walia: Your power cost would be close to around let us say 35% on net sales in Russia or more?

K. Srinivasan: We are saying it is 1.74 Ruble per unit of power. 1.74 unit Ruble per unit of power even today it is less than Rs.3.50. It is still significantly lower than what I pay at the lowest in any Indian space. It is less than Rs.3 at this moment.

Jasdeep Walia: This is after the increase?

K. Srinivasan: After the increase. So in terms of location it will still be the best location and it is competitive location, but a 16% increase overnight means that your new capital etc., everything is going to take that much longer to payback and particularly in the downturn when on a year-to-year basis there is a roughly 15% erosion in average selling price primarily coming out of a product mix change. So, the combination of all this is hurting us.

Jasdeep Walia: What proportion of your sales is power cost, let say for last year?

K. Srinivasan: It is roughly about less than 40% of the silicon carbide grits. So in a way if you take it as 16% or 18% roughly, you are talking of approximately 4% margin impact.

Sridharan Rangarajan: I just would like to tell that this there is a lot representation which has gone into. The increase is not final. We need to look at it now what the reaction from the government is.

Jasdeep Walia: Sir, is there any movement in SIC prices quarter on quarter like-to-like comparison?

K. Srinivasan: It has been flat. On an average realization basis it is flat, but I have this fundamental issue like I mentioned we are selling more metallurgical, consequently the product mix is unfavorable. It is same as last quarter, no change.

Jasdeep Walia: Also you talked about the price increase being taken in the abrasive segment. In the standalone business and you sounded confident in the last quarter of possible let us say 200 basis point improvement on quarter on quarter, purely on price increase which has not happened?

K. Srinivasan: Actually, here I want to clarify, we are seeing it, you will not seen yet because I think we saw the increase impacting best in a September margin of the business. The September margin is actually 200 odd basis point higher than the average of Q2 because we still have to unwind the higher value inventory that we have already acquired and so the price impact would only start kicking in from Q3 in full. So September already I have seen the 200 basis point increase, you will see in Q3.

Sridharan Rangarajan: As a whole of the year, I would say you will not be able to see as a full number at 14% etc., because you have to see that whatever happened until now and we would pan out for at least one or two months and then we will start getting there, so overall I think we will not be at that level, we will be probably at the level of about abrasives close to about 12% plus.

Jasdeep Walia: That is all from my side Sir. Thank you.

Moderator: Thank you very much. The next question is from Bhoomika Nair of IDFC Securities. Please go ahead.

Bhoomika Nair: Good afternoon Sir. You have mentioned on across the three divisions, first is abrasives, we are seeing quite a bit of demand pressure, so how are you seeing in terms of growth coming back and when can we see growth coming back in that segment?

K. Srinivasan: This is very difficult question because really we are talking of overall economy here, because abrasives goes to all the industry segments and practically all industry segments are lagging, none of them are actually booming, so to that extent we are not able to see anything dramatically becoming different. The only thing, we hope is that we will continue to take market share, what is happening is at these price levels and at these operating difficulties the smaller players and the traders are under even more intense pressure consequently they are vacating and this means that even in a declining market, we would be still able to keep those 4% to 5% growth.

Sridharan Rangarajan: Sequential quarter, abrasives, we have a volume growth that is the positive note, so we see some gain in terms of the volume happening.

Bhoomika Nair: In terms of the electro mineral division you mentioned at length about the power cost issues at VAW, we are obviously looking at some delays in terms of capacities. So does that mean that there will be some revision to your guidance in terms of topline growth for both this year and next year?

K. Srinivasan: I thought we will touch the topline in one shot, but I will do it now, as far as this year's topline is concerned, we broadly think that we will do about 10% better than last year. That we are not changing. We still are saying it is doable. We will try and get there. I must be careful because we are seeing some extraordinary things happening in the last couple of quarters, which we have never seen in many years. But with all that we still saying we are in line to get this 10% growth on topline. The pressure is really on the margins. So far up to H1 our margins have fallen by almost about 25% plus to last year. We said last time that we are likely at best to be down by between 5% and 8% to last year. Now that we are revising downwards further saying that we are likely to be down by between 15% and 20% to last year.

Bhoomika Nair: In terms of the operating profit?

K. Srinivasan: In terms of the profit yes. That is the only change that has happened because the sharpness with which we went down in Q4 from a high of Q2, we thought it would be the same sharpness with which we will come back from Q4. In this Q2, it did not happen. It has been a very, very flattish recovery and consequently, we think this quick recovery did not happen and so we are likely to still hurt on the bottomline even at the end of the year.

Bhoomika Nair: Sir, my other question is in terms of RHI, the acquisition, as you mentioned there has been a one time impact of the 4 Crores on inventory, which may not recur as such, but when do we see that is earning profitable?

K. Srinivasan: I know EMD margins come back to 14.5 if you remove and look at it. Sridhar and I were saying that almost every quarter we come back with one exception. We don't want anymore exceptions to talk about but the fact of the matter is it is an exception that came in. Anyway what we think is that this 4 cr is something which we knew even before. It was a part of our due diligence process. Sridhar, explained the reason how they would value and how do we value when we bring it in, and we tried and made it exactly in conformance with what we do across all our businesses. We bought it at a significant discount to book value. You will see it in terms of our balance sheet number when you have it, we almost had a book value of roughly about 50+ Crores and we bought this business at one fourth of price. So, one fourth of book value or one fifth of the book value is what we bought because we have to add this back in our calculation, we know that it will take up two quarters to turn it around. We will be negative even in Q3 in this business and hopefully by the end of the year you will start seeing becoming profitable. I am being little more cautious now compared to what I would have been six months back because the sharpness with which we come back from a downturn is not visible now. We thought we will come back quickly, but the market conditions are not exactly favourable, though by the end of the year we should be able to do it.

Bhoomika Nair: Sir, why are there losses? Is it a product mix issue? Is it again a cost mix issue out here, which is there what we saw in Foskor, where there was a cost issue and we are moving ahead?

K. Srinivasan: Here it is not a cost issue simply because we were selling their entire production into our RHI system. There was no one customer outside RHI. It was the captive plant. Now for the plant, for the products, I have to go and look a new customers and when I am looking at new customers at a time when market does not even take from existing customers. So, they are giving that much longer to take the product, get it approved etc.. It is not a profitability issue, we have to just find those new customers.

Bhoomika Nair: I will come back in the question queue. Thank you.

Moderator: Thank you. The next is from Bhalchandar Shinde of B&K Securities. Please go ahead.

Bhalchandar Shinde: Sir, wanted to know regarding the Electro-Mineral business, as you said that last time Crystalline and metallised business share. It is like since photovoltaic's sector is going through major slowdown then we said that our other kind of a material is getting sold more. So how exactly the mix is changing on the Electro-Mineral side, right now and will the margins remain at these levels or is it expected to improve?

K. Srinivasan: There are a couple of things, one is we are talking in the silicon carbide of a product mix between metallurgical grade and Crystalline. Basically our businesses are primarily tuned towards making more of Crystalline because it is more value adding. This Crystalline grains are used in many application. It is used making an abrasive product, refractory product in some ceramics, one of the things which we have created I mean in the last 5 to 8 years and grown significantly is to convert it into micro powders for cutting silicon ingot to wafer. Now this business by itself was booming primarily out of the US and Europe in the last 5-7 years and we were participating and over a period of time we have established ourselves as one of the leading players in terms of quality for the premium manufacturer. Unfortunately this part of the business has completely shifted out to China, which plays the same game with significantly inferior quality of product at much lower price. So the industry remains active but the locations have moved, it did not move slowly, it moved in almost 6 months. In 6 months the entire industry just moved of to China, so this is a story there and consequently we had to readjust our business model to see whether to supply crystalline to other products, convert it to other applications or try and go to the lower end product to address the Chinese market. So we are working on this with several options, some of it is already happening, many of it are yet to happen and that is structural change that Sridhar mentioned and that would play out in the next three quarters to a year at least. In the meanwhile the significant part of the fusion we are trying to shift towards metallurgical. It is still profitable but a lower margin business, but the market is local. If I produce in Russia I can supply to CIS countries and nobody can come and compete with me there. It is a reasonable product and that is what we are trying to do. That is why we are running plants flat and supplying to this industry. Overall, it gives me the profitability but it is not as well as we would like to be.

Bhalchandar Shinde: But then how much growth you see for this metallurgical silicon carbon?

K. Srinivasan: We would not source metallurgical beyond a point, simply because it is like I said a local business. We have to try and see that we supply to the industry around our business. It will not be able to carry another $140 of freight per tonne to ship, let us say to Europe or to US.

So this is constraint by the availability of market in the near by country. That was the reason why we are going slow with the expansion as well.

Sridharan Rangarajan: It is just a product mix, but the capacity we are fully utilizing and the impact would be on realization due to the average mix.

Bhalchandar Shinde: Sir regarding Thukela refractory, I guess in this refractory's we can sell the products to the local business and for the export it does not become that much viable so how much potential we see for that refractory's on the local site?

K. Srinivasan: Thukela refractory's if we run it flat out we will cross 200 Million brand a year.

Sridharan Rangarajan: This is when we run the refractory's in a particular product composition, but it would take I think a minimum of about two to two and a half years, by the time we reach that kind of volume. This is the capacity that we can get out of that. Also there is the opportunity for us to use the same technology, bring it into India in terms of the steel refractory's where we can cross leverage their learnings.

Bhalchandar Shinde: Sir, in the domestic side for the high end abrasives, are we facing kind of a competition from the competitors like 3M and Saint Gobain or it is like I had words with some of your competitors they said that high end competitors are increasing and we might face a kind of a margin pressure on the high end abrasives?

K. Srinivasan: Everybody who sells anywhere in the world is available in India and we also compete with them in other markets of the world. So, unlike other industries there is no protectionism. We have been in this competition now for a long, long time. We compete with all the names you mentioned and we compete very successfully with all these names. I think we are not losing market share with any of them. We probably are gaining market share because imports are becoming that more expensive with all these depreciation that has happened in the last one year. Having said that I must acknowledge that with the kind of pressures they are all going through in Europe and US there is that more anxiety about all those big players to come and compete in the Asian market, India and China, and they are doing it aggressively. If they come and drop prices in some specific areas to that extent the margins remain under pressure. It is just happening in some pockets but that is not something which is unusual. This has been there for a long time now.

Bhalchandar Shinde: Last question was on the quarter side how much upside I mean how much Tokelau contributed for the sales?

K. Srinivasan: Rs.8 Crores.

Bhalchandar Shinde: Thank you very much.

Moderator: Thank you. The next is from the line of Naisar Shah of Birla SunLife Asset Management. Please go ahead.

Naisar Shah: Good afternoon team. Sir, just wanted to understand when did this power tariff hike happened in Russia?

K. Srinivasan: It happened in July.

Naisar Shah: Sir also wanted to understand while obviously you will not like that tariff hike, but assuming you know it continues for sometime then what happens to your Q4 margin recovery that you are talking about? In the reversal of these, what happens to an industry dynamic assuming this does not reverse then?

K. Srinivasan: Taking a worse case scenario, assuming it stays at 1.74 Rubles and assuming we continue to do the same product mix as long as I can still sell 6300 tonnes a month I am quite okay. I will still make margins which are in line with what we want.

Sridharan Rangarajan: While the prices of the power is growing, we have the benefit of Petcoke going down so this will have some amount of compensation. The power is going up but at the same time we also get some benefit out of sand and pet coke, so we are planning that in worst case scenario, we may have to handle this.

Naisar Shah: Sir what happens to the industry while you said you will still be able to make money? What type of capacity will not be profitable at current power cost in Russia?

K. Srinivasan: In Russia with this power cost, our capacity will be able to fully produce them. We will be profitable. I think, we will are still be a unit, Rs. 2.89 we are still very competitive.

Naisar Shah: I am saying what happens to the other competitive, what percent of capacity in Russia will go out of the business if power tariff remains at this level?

K. Srinivasan: In Silicon carbide production there is nobody else in Russia who produces the silicon carbide. So if we are talking of let us say as a major power consuming industry let us say you are talking of ammonia, or you are talking of an aluminum smelter, etc., all of them. Aluminum you know as today $2500 tonne and everybody is dealing with that so those are the bigger boys who have even more deeply impacted by the power increase. It is not anything to do with our industry. It is a general industrial linkage.

Naisar Shah: Thank you very much.

Moderator: Our next question is from Abhijeet Vara of Enquiries Securities. Please go ahead.

Abhijeet Vara: Good afternoon Sir. My first question is the capex, which you have mentioned 160 to 170 Crores. Could you please give me a breakup of approximately how much will going to what facility and when do we expect the commissioning to happen?

K. Srinivasan: Abhijeet, we can talk about that broadly later, but standalone would be in the range of about 70 Crores and the rest would be on the consolidated which basically typically on the Foskor expansion.

Sridharan Rangarajan: Roughly about 40 Crores going to the Foskor, about 25 Crores is going into Volzhsky for improvement of our processing capability etc., so that is probably the random numbers we are looking at, and we are looking at in terms of additional capacity we have already explained to you Foskor potentially brings in another 5000 tonne of monoclinic and crystalline capacities, which is one of the most modern efficient tilt furnace of its kind anywhere in the world. We are hoping to see some benefit kicking in even in a very soft market. As far as Volzhsky is concerned it prepares us to address a change in product dynamics and also makes some more efficiency in terms of processing our grains. The other two capacities we mentioned earlier is one a technical project in the EMD business. It does not add anything in terms of immediate tonnage to our business, but brings in a new range of products for the refractory industry. We would be roughly producing 3000 tonnes of alumina Zirconia that we are producing in Electro-Minerals, hopefully from December – January and which again gives us a completely new value added products and also makes us more competitive. These are broadly the major capex’s. In addition to that we mentioned that we will invest in two generators which we will put in our subsidiary unit for generating gas based power as you know Tamil Nadu we had suffered like nobody else.

Abhijeet Vara: So most of this facilities you mentioned will come up in Q4 of this year?

K. Srinivasan: All we have mentioned is that it will be up and running in this quarter this year.

Abhijeet Vara: Secondly, in the last quarter’s concall you had mentioned that going forward potentially the supply demand situation might improve with most of the competing facilities becoming unviable. What is your take now, by when do you think it should be in your favour the supply demand situation?

K. Srinivasan: I was hoping that it will happen faster than what it is playing out, because it is really coming out of the demand not picking up fast enough. I still believe Q4 we would be up, to a reasonable utilization across our companies.

Sridharan Rangarajan: Abhijeet, that comment what was made in relation to the photovoltaic industry as well, it is a generic one, and hence some of them would become unviable. Hence the manufacturers could make use of that. That is the context in which it was made.

Abhijeet Vara: So it is not in general about the silicon carbide is it only for Photovoltaic?

K. Srinivasan: Yes.

Abhijeet Vara: Foskor and China are they profit making or how is the performance this quarter?

K. Srinivasan: China is doing better but it still loses money. We have a CEO who has come in, a Chinese gentleman; we have a new Chinese director who is hopefully joining in from this quarter. We have a strong game plan for China and we hope that we would get us into better shape by end of this year. It still loses money but marginal.

Abhijeet Vara: Foskor?

Sridharan Rangarajan: Foskor at the end of the year we will be break even almost. At the moment we are losing money. Foskor was a profitable company until last year. This first half they are making a loss at the end of the year they will be having a little loss to close.

Abhijeet Vara: Thanks Sir.

Moderator: Thank you. Our next question is from Vinay Rohit of ICICI Prudential Life. Please go ahead.

Vinay Rohit: Sir, could you just elaborate on when you said that margin in abrasive has been improving in 3Q, but you do not expect improvement in EMD in Q3 and so why do you think the margin improved in abrasive in Q3 and why not in EMD?

K. Srinivasan: Vinay, could you repeat the question is this relating to abrasive or industrial ceramic?

Vinay Rohit: Related to abrasive that the margin will not improve in Q3, and why not it will not improve in EMD?

K. Srinivasan: What we said is that we are seeing a margin improvement in the month of September, we started seeing them. The price announcement were made in sometime in August, mid of August, so the realization start kicking in September so as you see that as this margins start kicking in we say that as the full year we will not be reaching to the level of 14%-14.5% so full year would be in the range of about 11% to 12% and we are saying that this will start kicking in coming Q3 and Q4 you will start seeing that margin but on an full basis we would not hit that number.

Vinay Rohit: The EMD where do you think the year will end?

Sridharan Rangarajan: EMD, we think the year somewhere in the range of about 10.5% on the full year basis.

K. Srinivasan: May be it is good that we say we broadly expect these margins across on all segments on a full year basis

Sridharan Rangarajan: So over the full year basis we expect EMD would be about 10.5%, ceramic should be in the range of about around 19% and abrasive in the range of about 11% to 12%. That is how we are looking at. Overall margin we expect to be in the range of about 13% to 13.5%.

Vinay Rohit: Sir just a question we have seen margin from 20% to 10% EMD so do you think that 20% is pretty much gone and the new normal would stay at let us say between 10% and 14% for next few years?

K. Srinivasan: The normal of 14.5% in the last two quarters and we think we are every time telling you why this is where we are but for the exceptional. I think we must look at new normal achievable is again only around the 14- 14.5 for some more time till we have a better product mix.

Sridharan Rangarajan: Until we address the structural issue of micro capacity.

Vinay Rohit: Thank you.

Moderator: Thank you very much. Our next question is from Manish Goel of Enam Holdings. Please go ahead.

Manish Goel: Just a clarification on the initial drop in operating profit, you said 67 cr drop was 17.7 Crores from power cost, how much was the effect from Micro grits lower sales?

Sridharan Rangarajan: Rs.12 Crores. This is a movement between H1 of last year and H1 of this year so, it is really a movement that we are talking off to that extent it is not a quarter on quarter thing.

Manish Goel: What was the other three items?

Sridharan Rangarajan: I will just quickly recall them, power and fuel impact is about 17.7 Crores, out of that about close to about 8 Crores is from Russia and the balance is from India. Foskor cost push versus price increase is about 12 Crores. SIC micro grit sales impact is about 12 Crore then the new business acquisition loss is about 6.6 Crores, volume drop in abrasive refractory's versus cost push, etc., is about 19 Crores all put together.

Manish Goel: Just to broadly infer from the guidance you are giving for the operating profit, a drop 15% to 20%, what it infers is that in second half we are broadly looking at 10% to 15% growth over first half number, so we just wanted to know that is it going to be driven by cost saving or is it going to be driven by your movement in your sales realization of the margin? which segment will drive this?

K. Srinivasan: I think, the volume growth would be the increase in margin, the kind of margin that we are looking at one is the volume growth compared to H1versus H2, second is some of the cost actions that we have started working on that and third is that there is the exchange rate what we are looking, that is to say, instead of import can we use the domestic material and those divisions would also drive the margins to be on this. Where the segment I would say abrasive would pick up slightly and ceramic would maintain and the Electro-Mineral also will also remain same.

Manish Goel: Thank you very much.

Moderator: The next question is from Piyush Mittal of Franklin Templeton. Please go ahead.

Piyush Mittal: Thanks for taking my question. One basic question I had was on abrasives business. I was wondering if it would be possible to give some understanding of what raw materials are used for bonded and coated separately.

K. Srinivasan: I think Piyush we use various alumina, we use silicon carbide, we use Zirconia, all these are used in both bonded and coated, along with the grains we also have in the case of coated backing material, which includes paper, fabric, cloth, glass fabric etc., so this is broadly the raw material.

Piyush Mittal: Second question was in terms of channels of sales, like may be through distribution channel or directly to the OEMs, is there broad breakup that you guys have?

K. Srinivasan: About one third to direct customers and two thirds through the channel.

Piyush Mittal: There has been some talk at least in the previous conference calls about this diesel catalyst convertor business with the company in Japan. I was just wondering, if you can provide some update on what is going on?

K. Srinivasan: We are still working with them. We are qualified in a couple of preliminary testing. They have gone into expensive testing like any auto component, I think they have a qualifying process, which takes anywhere between two and three years. We are in a fairly advance state and the reason we did not talk too much about it is we still have to get the contract till we get that contract we have to be quiet about it and see what is it. We are in testing with them and we have passed a reasonable number of tests. We still have some miles to go.

Piyush Mittal: Are there other companies or Carborundum is the only company?

K. Srinivasan: There are two other companies already supplying to this industry. We will be only the third one.

Piyush Mittal: Now just one question on post the announcement on reform, I was just wondering if you guys have seen any uptake in volume in the month of September and October, I mean October is already behind you, has any uptake in volume happened or it has just been?

K. Srinivasan: None. There is no impact on the ground.

Sridharan Rangarajan: I think we should wait for the festive seasons to get over and see what kind of reaction it brings.

Piyush Mittal: Any discussions you had with customer? Any feedback that you got from them that makes you..?

K. Srinivasan: Nothing has happened of significance whatever has been happening, it continues. There has been most fundamental excitement or change is something dramatic happening of late.

Piyush Mittal: These are all the questions I have. Thank you.

Moderator: Thank you. Our next question is from Vinay Rohit of ICICI Prudential Life. Please go ahead.

Vinay Rohit: Sir, just a question last year we had a full year tax rate of 28% this year for two quarters it has been close to 32%, so what is the number to look for in for the full year basis?

Sridharan Rangarajan: I think it should be around 29 to 30 because you see the micro grit was going out of a SEZ so to that extent you see this 28 will definitely move up towards 30.

Vinay Rohit: Thank you Sir.

Moderator: Thank you very much. I would now like to hand the conference back to Mr. Jasdeep Walia of Kotak Securities for closing comments.

Jasdeep Walia: On behalf of Kotak Institutional Securities, I thank the management of CUMI and all the participants for attending the call. Thanks a lot.

Moderator: On behalf of Kotak Securities Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.