"Carborundum Universal Q2 FY14 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Carborundum Universal Q2 FY '14 Earnings conference call hosted by IDFC Securities Limited. As a reminder for the duration of this conference, all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during this conference call, please signal an operator by pressing "*" and then "0" on your touchtone phone.

At this time, I would like to hand the conference over to Ms. Bhoomika Nair. Thank you and over to you, ma'am.

Bhoomika Nair: Thanks Faisal. Good afternoon everyone. Welcome to the Carborundum Universal 2Q FY'14 Earnings call. The management today is being represented by Mr. K. Srinivasan, Managing Director, Mr. Sridharan Rangarajan, CFO and Mr. Raja Mukherjee, DGM, Internal Audit and Strategy.

I'll now hand over the call to the management for the initial remarks, post which we will open up the floor to for Q&A. Over to you, sir.

K Srinivasan: Good morning to all of you. Thanks for joining the earnings call. Let me start by wishing you all Season's greetings and a Happy Diwali. We had a good quarter, we had record top line sales both at the standalone as well as the consolidated which is a very good sign, considering the fact that we are still coming out of the downturn in most of the major geographies. Large part of the sales growth I would say came from the fact that we were able to take market share. I think we were able to not only hold to our share in all our geographies, but actually probably take a little bit of the market share, which meant that our top line grew by 10% on a sequential basis and about 5.8% on a quarter-on-quarter basis to Rs.552 crores at the consolidated level.

On a standalone, the growth was even better 11.1% on a sequential basis and 5.6% on a quarter-to-quarter basis at Rs.299 crores, we almost touched the magic figure of Rs.300 crores. So sales-wise it was all good. Margins were under pressure, we delivered an overall profit after tax of Rs.28.5 crore, marginally higher than the sequential quarter, despite a lower dividend income which is actually timing issue, but on quarter-on-quarter basis, it was low.

Overall, it was I would say the margins were under pressure and we'll explain as we go segment by segment. Abrasives, consolidated level Q2 sales was Rs.222 crore against Rs.210 crores. Growth was 7%, Sequential growth was even higher at 9% from Q1 sale of about Rs.206 crores. Market share growth was the main reason. I still believe that the actual consumption of abrasives has actually not grown in this quarter by about 10% that we are talking of, so consequently clearly its market share. We did reasonably well in also the smaller markets like what we have in India, in addition to U.S., Middle East etc.

So overall, abrasives it was a good performance, margins were under pressure largely because a significant part of the imports happened when the rupee was trading at 68. So you will see margin improvement coming later because price increase effect has just not struck in as of now.

On the electro mineral business, I think it was again a good quarter, sales was Rs.216 crore versus Rs.185 crore last year, 17% growth, all geographies did well, sequential growth was 11%, the electro mineral sales in India grew 20% on a quarter-on-quarter basis and 4% on a sequential basis. Growth largely came out of our doing better in the specialties and the aluminas as well as also probably having the last bit of a micronizing capacity being utilized, so overall it was a good quarter, I must say in the electro mineral.

Russia as we have expected did have some disruption in power supply, but we tried to compensate by doing extremely well in terms of utilization, the time available to us, strong shift in product mix with focus on the metallurgical which meant that we did much better than what we planned, we did about over 17,700 tons of fusion which is almost near what we did the first quarter in spite of the disruption in power supply. In Rouble terms, we also had better prices, which meant that volumes dropped sequentially 4%, prices grew 4% so effectively we actually did up very well overall in Russia.

Foskor Zirconia, the bubble plant started commercial production, we blew the first set of bubbles and we had good acceptance, I would say very positive feedback from key customers We did very little-as such as bubble sales, less than 50 tons, but as we speak this month or the month which we are concluding today, we should have more than a 100 ton bubble out of the plant. So really the bubble plant is picking up which is a strong positive sign. Margins are under pressure in Foskor simply because we are testing our bubble plants, so power is up, consumption is up, but the corresponding production will start kicking in as the capacity starts ramping up.

On the surrounding side of the business, the metalized cylinder business is strong. Q2 sales at Rs.124 crores versus Rs.111 crores in sequential quarter, it was better, growth is 11% both Industrial ceramics and refractories did well. On a quarter-on-quarter basis, it’s 7% lower simply because we had a couple of big project orders in Q2 of last year. Only worry in the ceramics side of the business is that the Australian Tile business is significantly slower largely because though the coal shipments out of Australia is still up, compared to last year, the price of coal going out of Australia is down to as low as about $80 per ton which is significantly lower than what it used to run last year. Consequently most of the manufacturers are actually now trying to make do with the existing lining or trying to use lower, cheaper quality linings. So there the margins are under pressure, business is also under pressure this quarter.

On the CAPEX side, I would say that we did on a consolidated basis about Rs.48 crores of CAPEX. We are in line to do as we committed around Rs.100 crores as we said earlier. Overall, I would say it was a good quarter, satisfying in terms of top line growth. We are aware why the margins are under pressure and we think that will also ease as we go forward and the price correction start kicking in and also imports start coming down to realistic level with Rs.62 a dollar.

Now I will request Sridhar to take forward with the financial numbers.

Sridharan Rangarajan: Thank you sir and good afternoon to all of you and Happy Diwali. And we'll quickly walk through the results for the second quarter as well as the first half. I think on a sequential basis, sales grew by Rs.52 crores which is 10.4%. However the PBT dropped by about Rs.0.6 crores. Out of the incremental sales of Rs.52 crores and Rs.0.6 crores of drop in PBT, standalone increase in sales was about Rs.30 crores and PBT drop was about Rs.0.6 crores. That means subsidiaries and JVs contributed to Rs.22 crores in sales, it's kind of flat return. That's how the overall summary looks like.

On a quarter-on-quarter basis, sales grew up by about Rs.30 crores, which is kind of 5.8% growth, PBT dropped by about Rs.8.2 crores out of the incremental sales of Rs.30 crores, and drop of Rs.8.2 crores of PBT, standalone sales increase was Rs.16 crores and PBT also increased by about Rs.2 crores. So which means more or less we know the standalone PBT delivery is fine. However, the subsidiaries and JVs contributed to the Rs.14 crores in sales, they resulted in a drop of about Rs.10.2 crores in PBT. And I'll cover that later about it.

CUMI standalone operating PBT percent remained the same at 10.4% compared to the similar quarter last year. On a sequential basis, there was a drop of 1.4% in PBT margin, the drop came due to the lower dividend receipts from subsidiaries and JVs which are typically seasonal, normally you get the dividend outflow in Q1 and that's where this difference comes.

As far as the consolidated numbers are concerned, PBT margin dropped basically similar to the standalone margins, there was drop of Rs.8.2 crores on a quarter-on-quarter basis. This I would say you can say three buckets, loss of profit in CAPL which is our Australian operations is about Rs.4 crores, I think this is largely due to the volume drop, the volumes have dramatically dropped in Australia as Mr. Srinivasan was hinting, the coal price was at the peak from $140, today we are looking at about $ 80, so definitely coal mining activity definitely has come down, it's impacting us in terms of the volume, plus we also had some exchange again in the last quarter versus this, so that also contributed towards that. So overall, Rs.4 crore is coming from Australia. And then the second reason is SEDCO, our power generation subsidiary which is due to the lower gas supply, there were some challenge in terms of the availability of gas. So that's contributed about Rs.2 crores. Again the third one is Foskor Zirconia, if you see that Foskor we had challenging last year as well, and I think, overall by and large, we have overcome the issues that we have. But we still have compared to the last year about Rs.2 crores. Foskor definitely is getting better, and as we see that the bubbles we started selling in this quarter, and we will start stabilizing in the next two quarters. The drop was negated to some extent by Gain in profit before tax from standalone business to the extent of Rs.1.8 crores, which came by way of higher sales in EMD business; since the profit margins remain constant.

On a sequential basis there was a drop of about 0.6 crores, 100 basis points, which happened due to the standalone variances as mentioned above and also the other subsidiaries had a mixed performance.

Now, if we move to by segments, abrasives PBIT margin at a consolidated level remain constant at about 9.8% it was same in the sequential quarter. From a standalone point the margin dropped from 11.9% to 10.5% in the current quarter, this is largely due to the exchange impact. Notwithstanding the price that would be put up, the cost impact due to the dollar versus Indian Rupees impact, that has costed us this.

On a quarter-on-quarter basis on a consolidated basis the margin dropped by Rs.3 crores due to the abrasives in India basically largely driven by the Indian business. Going to electro minerals PBIT margin of EMD moved from 10% in Q2, 12-13 to 10.4% in 13-14 this was an increase of Rs.3.8 crores. Out of Rs.3.8 crores, Rs. 4 crores comes CUMI standalone. And we saw that this is a mixture of few things, one is, a better captive power generation we have Maniyar giving us a better, power generation that resulted in lower power cost, as well as some of the better sales in higher aluminas. Lower loss in Thukela gave us about Rs.1 crore. These gains were netted off by higher losses in Foskor to the extent of Rs.2 crores as I explained earlier. And also, I would like to point out here is that Foskor comparing to the last half versus this half, the challenge is we have the new kiln operating. So which has got depreciation going at full swing as well as at the same time, since we are stabilizing the plant, the plant is not fully operational you have lot of other consumables as well as power going at normal costs. So that setup will start happening in the second half.

On a sequential basis the margins were also lower by Rs.3.5 crores in electro minerals. VAW had an adverse swing about Rs.6 crores due to increase in power costs almost the power cost stretched about 2 Rubles per unit at this point in time. There was also a drop in volume, which we just had the comments from Mr. Srinivasan and Foskor and Thukela remained similar losses as per the sequential quarter. The loss was offset to the extent of Rs.2.5 crores to Rs.3 crores from Maniyar higher power generation.

As far the ceramics is concerned PBIT margin of ceramics moved from 18.8% in Q2, 12-13 to 13.7% in Q1 13-14 and now we are about 11.9% in the current quarter, the drop is about Rs.10 crores on a quarter-on-quarter basis and about Rs.0.5 crores on sequential basis. On a sequential basis, the margin for standalone business has become better on back of improved Metz businesses and repairs and maintenance orders from refractory businesses. Standalone gave Rs.3.5 crores increase in profit, however CUMI Australia we just covered that in terms of challenges, they faced, they had a lower profit of 2 crores. And other challenges are also our joint venture with Ciria which operates largely in petrochemical industry and lot of project based business also had challenges in terms of delays in projects etc. MMTCL, our another joint venture also had challenge in terms of refractory business. So put together that resulted in lower profit.

On a quarter-on-quarter basis, standalone profit came down by Rs.1.3 crores and Australian profit came down by about Rs.3.7 crores Ciria and MMTCL contributed about Rs.2 crores. The other entities contributed for the balance fall. So these are the broad reason why we had differences in ceramics.

Now going to CAPEX, I think we just covered Rs.48 crores of year-to-date CAPEX. Our plan was about Rs.100 crores on a full year basis. So we are trending towards that.

Coming to debt-to-equity, on a standalone basis, the debt-to-equity almost remained same at 0.19 compared to June. But, on a consolidated basis, the debt-to-equity ratio improved to 0.43 as of September 2013 from 0.45 as of June. The total debt as of September was about Rs.489 crores and this was about Rs.434 crores as of March 2013. So there was a Rs.55 crores pick up, but this is not just that loan has gone up; it's largely due to the exchange fluctuation. When you translate that you know, that had an impact of about Rs.40 crores, so that itself it a big chunk. So truly the loan has not gone up to that extent. So that's by and large the loan position.

As far as Forex, I think we are continuing to be prudent as we have the policy of taking the net cover, and the Forex impact is fully disclosed in the P&L you had, seen in the P&L impact itself. As I said, the translation gain in consolidated sales, which is basically quarter-over-quarter, when you translate the subsidiaries to the Indian rupees, there was a higher sales of about Rs.14 crores, and sequentially it is about Rs.16 crores and year-on-year it's about Rs.14 crores. Other than that, rest of the numbers are disclosed in the P&L as well as the foreign exchange gain or loses are concerned.

So that's by and large overall summary I think just to recap, I think volumes are there, but cost stress is there, and Foskor I think we have more or less addressed the challenges and we are in process of moving to profit growth in next two-three quarters we'll start stabilizing. Thukela more work need to happen, I think it will take about few more quarters before we start addressing the issue. Micronization, alternate capacity utilization is on track, and we continued to say that, it will take about 18 months - 24 months to address those issues.

I think with that, we will open for question and answers.

Moderator Thank you very much sir. Ladies and gentlemen we will now begin with the question and answer session. First question is on the line of Bhalchandra Shinde from B&K Securities.

Bhalchandra Shinde Sir, how much is the price increase we have taken in, and in which segments we took for last quarter?

K Srinivasan See, if have to look at the price increase, we are trying to take increases across all the four large product groups, abrasives price increases ranging between 3% to 6% is being implemented, it's not still impacted the correction that's being put in. The price increases in mineral business may range anywhere between 6% to 8%, but again, it has to flow in as we move forward. There is a marginal price increase also in the ceramic business as well as in the refractory business. But most of it has to start kicking in only from Q3.

Bhalchandra Shinde Sir sorry, I missed out the part of SEDCO Power Plant regarding the margins loss, you said something regarding SEDCO Power Plant.

Sridharan Rangarajan It's not a margin loss, we have a captive gas generation plant, the supply of gas was lower due to some technical challenge faced by the ONGC which resulted in lower power generation.

Bhalchandra Shinde Sir, regarding Bubble Zirconia, how much market potential you see it, like we are expecting to do 100 ton by this month end, how much you see over a period of time, it's like in FY15 how much we expect to do?

K Srinivasan See the Zirconia capacity of what this bubble plant can address approximately market potential is about 120,000 tons, our capacity would be less than 6,000 tons, so we are not even 5%.

Bhalchandra Shinde Okay. And sir, where exactly this will be utilized, any specific applications where we have user industry?

K Srinivasan The basic industry for which this can use can range from pigments, color, piezoelectric crystals, Zirconia rods for the nuclear industries etc. In addition to traditional things like grains, abrasives, refractories and all the traditional industry which we already can address, there are other refractory like Zirconia's.

Bhalchandra Shinde Okay and sir, in other expenses, we actually slightly improved any specific reasons?

Sridharan Rangarajan If you look at this Bhalchandra, you can see that it keeps varying between 23% to 25%.

Bhalchandra Shinde Right.

Sridharan Rangarajan If you see the Q2 '12, '13 we are in line, it is about 23.1% and we are now at about 24%, 23.3% of net sales, it is more or less in that range and to some extent there is volume related expense also goes there. So you are always the range is somewhere 23% to 26%, it keeps hovering in that range.

Bhalchandra Shinde Sir, our raw material cost as a percentage of sales increased, was it because of higher imports or?

K Srinivasan See the import came in during a significant part of the quarter at Rs.68 to a $1.

Bhalchandra Shinde Okay.

Sridharan Rangarajan I mean you are talking about standalone or consol.

Bhalchandra Shinde	Standalone.
Sridharan Rangarajan	Okay, see the standalone largely is driven by abrasives cost going up which is basically because of the import content involved in that. And as Mr. Srinivasan said, that we have been importing and the average cost somewhere should have been in the range of about Rs. Rs.63 plus, that would have gone into our cost and that's where it is hitting us.
Bhalchandra Shinde	Okay, so it means like it will subside in further quarters.
Sridharan Rangarajan	As rupee starts stabilizing and probably we will start seeing this.
Moderator	The next question is from the line of Kasyap Pujara from Axis Capital.
Kasyap Pujara	Just a couple of questions, firstly on the abrasive front, my question is, are you seeing that volumes are now bottoming out, I mean have you hit the worse now, I mean and do you think that volumes can hold out now and you just have to wait for getting price increases pass through eventually?
K Srinivasan	See, we have gone up on volume, if you see the top line sales growth is roughly about 10%. We are hoping to keep this volume growth around this 10% mark even in the next two quarters.
Kasyap Pujara	Okay.
K Srinivasan	Which really means if you have to take another view about the consumption has not grown by 10%, our estimate is the abrasive consumption probably in the first six months should have been flat or down by up to 5%. So this additional growth that we are seeing is largely taking market share, and where is the share coming from? The share could come from two things, one is import substitution, the second is taking away from the marginal players. We think both are happening now.
Kasyap Pujara	Okay, And the margin improvement like what you are saying is that you had a rupee currency issue, I mean in the last quarter and the margins was dominantly under pressure because of that, so going forward can we expect domestic margins to come back in that sense, I mean now that rupee has broadly stabilized?
K Srinivasan	Two things are happening. One is, we are trying to push prices up a little bit, but we will have to be careful, because like I said, the actual demand is not growing. Our volume growth is coming from market share. So we can't be far too aggressive on pushing our prices, though we are attempting to take up prices to reflect real cost position, and also it will help by the rupee coming down. So a combination of these two should definitely help.

Kasyap Pujara Okay, and in the international side again, on the abrasive front, if I see I think sequentially there has been a reasonable margin growth. So that growth has been attributed to what, it is Wendt's, because that numbers were decent or is it that Russia is actually picking up.

K Srinivasan See the consolidation has got two pieces which are now getting better, one is clearly this technology withdrawal and all that is behind us and we are now doing better and Wendt and it can only get better going forward. Sterling has also done reasonably better, Sterling has because they are unlike Carborundum more agri product oriented. So Sterling's margins also are getting better.

Kasyap Pujara Okay. And again, in the international piece, there has been a reasonably good jump in the capital employed on the abrasive front, obviously this is year-on-year, now sequentially it's more or less flat, but I mean what is it that we are looking at from a longer term perspective on that front because that has been one of the culprits to actually suppress our margins in the domestic front at times?

K Srinivasan Are you talking of margins or you are talking capital employed?

Kasyap Pujara Yes, I am saying that margins on your capital employed has increased and the margins have been volatile there, so essentially I am trying to understand what is the kind of returns that you are looking at on a longer term basis from the international, predominantly the Russian abrasive business here?

K Srinivasan Yes, let me say we have actually first on the international businesses we are trying to get our sales and be profitable.In Russia the local abrasive consumption is only declining year-on-year, the manufacturing in Russia is growing, so consequently we have to refocus and that work is still work in progress. The other piece is China is getting better, but it has to be refocused. China initially was largely for making abrasives for sale in other parts of the world, predominantly India, now we want increasingly refocus to say we want to sell more into China itself. So that is also work in progress. So you must give some time for the international businesses to come into some kind of a stable contribution and priority is to stabilize the business and grow volumes.

Kasyap Pujara And just a last question, I think incrementally I think you have taken all the cost, be it Thukela or be it the expansions that you've taken up, the benefits are not panning out. I think if you can just throw some light on two things, one is, how you intend to basically get Thukela on track, it might take a longer time, I can understand, but what are the steps and what are the things we can do to actually shore it up. And second is that the tie ups that we had made for refractory, the technical tie ups that we had made, are we actually capitalizing on them and trying to better our offering in the local markets. Are we seeing some incremental traction in terms of business in the value added refractory front?

K Srinivasan Yes, to answer your second question first, we had two tie ups, one with Sheffield Refractories and the other one is with Anderman. Sheffield was largely to address the steel refractory business and to a lesser extent cement refractory. Anderman was largely special refractory for the aerospace industry. Anderman is still work in progress, we have not had the kind of success that we anticipated, it's taking more time and this is also little understandable because the people who switch the slowest are actually the aerospace industry. So it is taking more than the anticipated time of trials and test, but we are trying to get there. Sheffield has made a big impact for us. The overall refractory consumption into the steel industry globally has declined by about 18% last year, in the first nine months, I am talking of the calendar year. Our refractory business actually has grown, this is largely because we are able to enter businesses and markets, which were traditionally not with us. For example, our tap-hole clay business, all that we brought along which Sheffield has helped us to take market share and grow our businesses. So for us, the tie ups are definitely paying and it is allowing to grow our business in extremely trying time, the refractory industry is probably the most stressed industry in India at this point in time, and to take market share and grow in this condition, I would say is a good achievement, and largely coming out of a new technical partner supporting us.

Now to answer your first question on Thukela; Thukela is actually, I think you know, the way we structured the whole thing. So we thought that we would get our quantities running to about 1,500 tons a month largely on the back of supply agreement with RHA and quickly getting other customers converted, both did not happened as expected. We had bought a business of book value 115 million rand at about 28 million rand, the rest of it actually is sitting in our reserves. So we bought it significantly below book value. But when you see the losses, we would continue to depreciate based on $115 million book value, so the depreciation in terms of 9 million rand hitting us in a year, the sale of what is inventory, which is also at book value also giving us negative. So to an extent I would say, a part of that will all go through the P&L. So I am not too concerned about just a loss that you see, but on the business side what we are really looking at is, that we need to get our supply contract with RHI, aggressively going forward, and that is actually moving positively and several new customers have been established in Korea in India etc who have started taking volumes.

We have also taken the time to resize the business for the first time in this place of South Africa, we went to a formal reduction in people, we could take out people and get the fixed cost down, which allows us to operate at lower volumes and breakeven. So we have done quite a few things in this time, and it as a stress business, new customers, established new products, established fixed cost, taken down supply contract with RHIs, getting better I am not saying it's perfect yet, but all this means hopefully in the next sequential quarters you will see significant improvements coming in. But to be completely out of wood, we will take three quarters. So I am not promising that next quarter onwards we will run into profit because we still have to clean up all the other things. But you would see it progressing. And overall for Carborundum, it would mean that we have a silicon carbide piece which is about 80,000, 85,000 tons, aluminas piece including specialties of roughly about another 60,000 tons. So it makes us more of a complete minerals company so that's really the objective. So on a strategic space, I think we have got it that right in this sense.

Sridharan Rangarajan Kasyap, just I would like to add two things here, one is on your previous question on capital employed. That is lot of that movement is resulting because of the translation impact, so you don't see that actually our capital employed is going up to that extent. And second is in the model what Mr. Srinivasan just explained is that we assume 25 percentage of the capacity utilization was suppose to come from RHI and that did not happen, I mean had we got that one, we would not have seen any loss at all, and we would have still managed, plus we would have been doing rest of the things. So that's just two perspectives.

Moderator The next question is from the line of Ram Hegde from Primus Investments Advisors. Please go ahead.

Ram Hegde Could you just throw some lighting on VAW, what was the colors that we achieved in the first half and how is that expected to move?

K Srinivasan Roughly about 35,000 tons we did in first half, 18 in the first of Q1 and roughly 17,700 in Q2. Hopefully we should do more than that in this H2, which means if we can do this year about 72,000 to 73,000 tons it will be very good, it will be the highest ever.

Ram Hegde So the volumes you are not seeing a problem really given the slowdown and all of that?

K Srinivasan Like I said quite a few capacities have gone out, I know capacities in Ukraine have gone out, quite a few capacities in Europe have gone out, significant capacities in China have been shutdown, so volumes are there we will take the volumes.

Ram Hegde And on the power cost really, I mean how is that being moving really, I mean could you give some color on a YoY?

K Srinivasan Right now, power this quarter is going down to about 1.91 from about 2.07, really so we are seeing a downward thing. See there are two things which drive power cost in Russia, one is, that the total generation is consumed by electricity consumers as well as the steam consumers. Unlike in Europe and the US winter power tariffs in South Africa tend to be lower for some part of the months compared to summer tariff, because there is a customer for the steam that is there produced by the utilities. So generally going into winter, we see power tariffs actually starts going down, peak of winter again it gets stronger. So you should take it that, it would hover around 1.9 to 2 during the next part of the year. The public announcements made by Inter Row, which is a largest power utility supported by the government is that they would try and freze what they call is natural monopoly that's the word the Russians use, at about the current price level for the next three years, so that's a positive thing that we see. So this 19% Ruble term increase that you have taken during this year would probably be what we will see for the next three years. So which is not very bad.

Ram Hegde And on the expansion at VAW how is that progressing?

K Srinivasan We are going about it in a careful manner, see this we don't want to be seen as putting up additional capacities when power price goes up 18%-20%. So we are still negotiating, we need to get fair terms, we can't commit capex when power prices are not guaranteed and firm for us, so we have got all the things in place, but we are still holding back on the orders. But two things we have done from the technology work that we have done in the new project. We have started implementing those special technologies, giving us extra savings into our current plants. So that is what is really giving us this significant volume improvement? So let's say the new technologies are not being wasted, we are trying to use that to the extent possible and the existing plant to get up volumes.

Ram Hegde So but per se it was 15,000 ton that you are talking in sales?

K Srinivasan Yes about $7.5 million investment and about 15,000 tons in separate plant, that we are not putting it in the ground till the time we get a government assurance that for five years we get a firm power.

Ram Hegde And lastly, given in each of the three segments, could you throw some light on what percent of outlook you carry for the next 6 to 12 months?

K Srinivasan On a consolidated basis?

Ram Hegde Yes on a consolidated basis?

K Srinivasan Consolidated overall company we still say that about 10% top-line growth is in order for the year. We are positive on the abrasive business, because 75% of India we will do top-line, we will try and inch back on the margins hopefully if nothing dramatic happens we should get back there as well. On the ceramic business, ceramic business is a business which is going to be under pressure this year, simply because coal is under pressure, all the projects and power plants and everybody is under pressure. So we would try and keep sales up by about 10%, because we have lot of new projects running there. And margins would definitely be under pressure there. The electro mineral business is on mend there, we have seen the worst, and you will see it on the mend quarter-by-quarter. So maybe 15% top-line growth and probably margins getting better.

Ram Hegde And lastly on wendt really, I mean any color in terms of?

K Srinivasan We have not heard anything from them, the litigation continues, there is no move from their side, either to meet, either to discuss or to resolve the issue.

Moderator The next question is from the line of Jinal Seth from Multiact.

Jinal Seth Just wanted to understand, what would be the organized/unorganized split in the market currently?

K Srinivasan You are talking in the abrasive business in India?

Jinal Seth The abrasive yes.

K Srinivasan Yes, I would guess it's between 80:20, I would say about 80% would be organized sector and about 20% would be the smaller companies as well as imports.

Jinal Seth Would this split be similar in the past three to four years or is that changed?

K Srinivasan My sense is this year the 20% has taken a bigger share of the downturn.

Jinal Seth So, because I observe that our competitor Grindwell also grew around the abrasives business by around 7%-8%, so would that be your assumption they also would have gains on that?

K Srinivasan Yes, see because that's why I saw their numbers as well, since both of us seem to have grown in a market, which where the consumption per se doesn't seem to have grown. So really I assume that the 20 is what is impacted more significantly.

Jinal Seth And sir, what would you attribute that to, some level of import substitution and/or what would be your thoughts on that?

K Srinivasan See there are two things in this what comes other than from the two big players. One is this smaller companies which do what I call the cheap products and also the trade which imports from China. That I think has significantly impacted with the higher import cost etc. The premium end is a deliberate attempt by the stressed industry to shift. There is still a 5% of premium products which is imported from Europe and other places by the organized sector and they are under tremendous pressure now to get it locally done. So there is a deliberate attempt by these people to shift almost immediately and this business doesn't go to the small guys, it immediately comes to the top two players.

Jinal Seth In that case, do we have all the global players in India or they are entering or what would be the competitive scenario in that regards?

K Srinivasan All the local players are in India either through a representation or through small local conversions, so they are all here in India.

Jinal Seth Okay, and lastly, what would be customized products as a percentage of our sales in regards to Abrasives?

K Srinivasan It's about 35% to 30% would be what we call a special or customized direct to customer products.

Moderator The next question is from the line of Gautam Chaocharia from UBS.

Gautam Chaocharia Most of the detailed questions are answered. I have a couple of generic questions, one is on how are you looking at the inventory in the supply chain now, specifically when you are saying that lot of capacities have gone out and you are gaining market share. Are you seeing inventories running very tight?

K Srinivasan I have been watching what is happening in the let's say the auto sector and others where we are seeing a huge inventory sitting. In the abrasive business in India the inventories are running very low, largely because I think you see that while our sales has grown, we have also seen relatively prudent though the numbers you see is a combination of refractories, ceramic and all, the receivables has not grown proportionally. So we are actually collecting our money, we are being more than careful in terms of ensuring the payments come in for our sales. So we are not piling up inventory and both sides are not doing it. So there is not any build up of inventory in the system, which is a very good sign.

Gautam Chaocharia This is true for all the three businesses and outside India also?

K Srinivasan See, the other two business is direct to customer. Both the ceramic amd refractories, there I would say though there is no inventory build up, the receivable days are building up because project people are not paying on time. So there is an issue in terms of projects paying on time both in refractories as well in ceramics. This is a global issue, all the big guys are not paying on time. Abrasive business overall, there is not an inventory pile up at all. And on the mineral side, I think again, there is no significant inventory pile up, on the contrary I think most of the silicon carbide inventories that sort of piled up after the photovoltaic world disappeared, there is a clear moving up on the prices in dollar terms. So I think there is only good sign in terms of inventories. There is very little pipeline inventory. The only caveat I must take is that the sand, zircon sand still is in surplus, there is a significant inventory which is positive for Carborundum because we buy it.

Gautam Chaocharia And linked to that again, we talked about market share gains, but the broader demand environment and I am not talking necessarily about India, but in Europe also, how do you see that cycle evolving, again it's difficult to do that, but in your sense or at least how you are positioning the business for that?

K Srinivasan So, we will have to go geography-wise, US. Strong demand, second highest car sales, I think they probably again overtook China in car sales, really strong demand, energy prices are low, so US. is very positive on all fronts. Coal was a record low in 2012, marginally coming back in 2013. first time home improvements, new homes everything is coming back. We are not really seeing that kind of benefit kicking in to CUMI America, CUMI Canada, but you will actually see that we start getting our acts together. But US overall, very positive.

Europe, definitely bottomed out, the mood is better, sales are better, they are definitely looking more towards non-Chinese imports. So I think Europe also is positive. Inefficient capacities have gone down, but Europe is also definitely positive. Asia mixed bag. China, they are definitely not buying as much as they used to, but in select products they are still buying, not for consumption but inventory building up like in for example in bauxite or in some cases of coal, and I think they are definitely building up. So I think there is still demand there, our sales there is also a certain amount of pick up, but inefficient capacities are definitely going out there as well.

So overall, I would say, if you see in each product abrasives global consumption, I would say is still up, will go up, electro minerals will definitely go up, newer applications coming up, refractories is a bad story out of the lot because steel is relatively flat or declining, ceramic again relatively flat. So out of the four segments, two would be flat or negative, two would be positive.

Gautam Chaocharia Got it, but in the scenario of say demand picking up not strongly but even more than what we re looking at right now and given lower inventory in the system, lot of capacities going out, do you see the possibility of a real move up in margins etc for the year?

K Srinivasan I wish it happens. I don't want to say it will happen, but clearly wish it happens because you see all the signs are there, like I keep saying good times start with volumes coming back, margins come back second. If volumes are back, two quarters in a row, volumes are back not only for us for all the big players. So I think logically we must see margins moving up, unless something dramatic changes.

Moderator The next question is from the line of Vinay Rohit from ICICI Prudential.

Vinay Rohit I just have two questions; one on standalone elector mineral side. So we saw sharp margin improvement, are these margin sustainable given that you mentioned there was some sales from micronizing capacity. And my second question is, we have seen some of your inventory if you will both has gone up combined together by Rs.120 crores. So are we comfortable with this kind of inventory level, or you think this should come down?

Sridharan Rangarajan Rohit, the inventory and the receivables you are talking standalone or consol?

Vinay Rohit Consol.

Sridharan Rangarajan Now, on the standalone electro mineral we could see that the pick up sequentially is about say Rs.1.6 crores or something like that. And largely to the industry, we have as I was explaining to you, that we had a better rainfall and because of that we could generate higher power generation. We had about picked up about Rs.2.5 to Rs.3 crores of higher benefit out of that. And also with the aluminas and specialty aluminas sales.

And the question of sustainability I think definitely Maniyar is not sustainable, the rain season is almost over in Kerala, and as for the micro mico-mineral sales side, I would say, we are getting our acts together. So we need to wait and watch on that. On the consolidated inventory and receivable going up, I think we need to take out the exchange impact on that inventory and receivable. If you just take out that inventory and receivable, the exchange impact, the inventory and receivable going up is not significant at all. The same comment applies that what I have made on capital employed the similar comment applies to inventory and receivable as well.

Vinay Rohit Sir, if I look the EMD margin in overseas. So you did mention that margin has come down from 13.4%. So given that VAW will be operational, should we expected margin go back to Q1 level?

Sridharan Rangarajan See the consolidated EMD margin, at the beginning we were just covering is that it's impacted on few things also, Foskor, Thukela is there, and those I think I would say, Foskor in Q3 we see that some more volumes will pick up, the margins we will pick up. And Thukela we see that this story will take about at least another three-four quarters to stabilize. So that will have the impact. And well, we see that similar performance would continue unless something dramatic happens on the power side, I think the similar performance should continue.

Vinay Rohit But, you did mention that given that the loss in Foskor and Thukela were same, this impact must finally come from VAW, right, for this quarter?

Sridharan Rangarajan This quarter, yes, this quarter because of the vast volume, plus price offset, but power cost has gone up, we were at the 1.91 to 2.07 we picked up the rates, so that's a big impact.

Moderator Next question is from the line of Jasdeep Walia from Kotak Institutional Equities.

Jasdeep Walia Sir, what's happening on your maximizing capacity upfront, so what are the utilization as of now and how do you think that will improve going forward?

K Srinivasan There are two parts; one is the traditional silicon micro grit business, silicon covered micro grit business for the photovoltaic. We probably are in the last leg with our proven customers, because most of them have announced closure and so we are making the last shipments before November/December. Having said that, I have also realized most of these people are going to now close it, the big guys are going to close but they are also not going to completely shut down the plant, they would sort of re-surface in some kind of an MBO and probably do it under a lower cost structure or something like. There were some discussions going on the photovoltaic itself, that the business may not go down to zero but something could come up, that is in progress. The more definite longer term thing that we are working on like we keep saying is for the diesel particulate filter, they are saying there are several levels of approval because it's T1 supply to the automotive component, that work is going on, we are on track probably we should be seeing the big orders coming in only by 2015, because we have to go through four years of approving. There are couple of other areas where we are trying to stabilize this capacity like in micronizing, Zirconia, Bubbles etc there the first set of products are being made, first test was is also extremely positive, so we will have to see how this moves forward. So like we keep saying the complete running of this micronizing facility is still an 18 month project, capacity utilization is still very, very low.

Jasdeep Walia Sir, you are trying to micronize other materials here in this existing capacity, so the margin etc let's assume that the product is successful, margins will be equal to what you use to make earlier in SiC micro-grits.

K Srinivasan I think we will have to take it step by step, at the moment we are still improving the product, getting the volumes etc. Traditionally, the kind of margins our micronizing process makes tends to be significantly better than other margins, but we'll have to get our product, because it's a much, much more precision operation, we can just run this plant and do the normal grinding, which we don't want to do, because this is a superior plant and this is capable of doing something very unique and different. So we are working on it, so once it is established we will see these margins tend to be much better than the other margins.

Jasdeep Walia And also could you give us an idea on the utilization levels at Thukela separately for refractory's and the fusion capacity?

K Srinivasan So refractory's is about half, I would say about 50% plus, and fusion is running less than 25%.

Jasdeep Walia And how will the progression behave sir, as far as utilization is concerned?

K Srinivasan I think we are doing couple of things, refractory's we want to do more and more with direct customers in India and other parts, so teams are working on it, there is a clear shift from selling everything through RHI to selling directly and that is actually coming up reasonably well. In the fusion capacities quarter-on-quarter you will see improvement, hopefully in Q3 itself we should start seeing it going about 30%, 35%. As soon as we cross 50% we will start making money.

Jasdeep Walia So what were the losses at Thukela and Foskor this quarter?

Sridharan Rangarajan We don't share individually; I think we will have to wait for the annual numbers.

Jasdeep Walia Could you talk about the deltas YoY and sequentially?

Sridharan Rangarajan Okay, between Foskor and Thukela, Foskor there is no big change it is almost same as this one, Thukela also.

Jasdeep Walia Sequentially.

Sridharan Rangarajan Sequentially.

K Srinivasan Both of them are almost same actually.

Sridharan Rangarajan But on the half yearly basis Thukela will be higher, because last year Thukela was about two months versus this year six months.

Moderator The next question is from the line of Piyush Mittal from Franklin Templeton.

Piyush Mittal First question in the opening remarks, I think it was suggested on the electro mineral in VAW you saw maybe some positive shift and mix towards metallurgical. Could you maybe shed some light on what was causing that?

K Srinivasan See we have been in the last two years, pushing more and more into metallurgical, because the crystalline is just not moving as it used to, because crystalline goes to like micronizing for refractory's, abrasives, higher end application and that market still continues to be stressed.

Piyush Mittal But, sir why would the shift be positive then because I thought the…

K Srinivasan I think maybe I used the wrong word and I said positive, I think more increased shift to metallurgical we were making even more metallurgical compared to earlier.

Piyush Mittal Second question, is it possible for you to kind of share us the math when maybe let's say Foskor is running full capacity, and then you are using some of it to micronize here. How would the revenue realization, I think in the past you shared, I think the product realization at Foskor would be close to $5,000 per ton, if I am not mistaken. And then it will be brought to India to micronize it further. I mean if you can just maybe explain the mechanics a little bit more.

K Srinivasan See we will have to get this running first, I think at the moment we are still work in progress, and I think broadly the raw material is going to come from Foskor and these prices also keep moving, because depending on the application and then part of it would get micronized in India, and that's where this work is going on. I think you will have to give us sometime before we can get more this thing on the kind of margin that we can make.

Piyush Mittal Maybe is it possible to understand how much will be the top-line at least, I mean margin we can talk about maybe later?

K Srinivasan I think Piyush it will be too premature because we need to establish the product. What we can say is that, we have a 3,000 tons capacity of alumina Zirconia that we have established here. So we need to see that, I mean once we pick this up and establish the product etc, than we will have clarity in terms of the volume, as well as the price and the margins etc.

Piyush Mittal Okay, additional question on silicon carbide global supply demand, what's the view on in general pricing for the commodity?

K Srinivasan Prices are generally getting better from the last couple of quarters, because the availability has come down, capacity global capacity is only a guesstimate because the Chinese capacity which is the early operational or functional it's difficult to guess; anywhere between 1 to 1.5 million tons would be the global capacity. And we are about 80, 85.

Moderator The next question is from the line of Ravi Purohit from Simple.

Ravi Purohit: Sir, most of my questions have been answered. Just a little generic question on the refractory business, you said that increasingly focus will be to sell directly to the clients in the domestic market, and about 12 years back we had sold our refractory business to Vesuvius

K Srinivasan Correct.

Ravi Purohit: So if you could just give us a little background brief about that decision and now directly selling to customers and what is the overall refractory business like in India and how are we positioned there, just briefly, if you could share your thoughts on that?

K Srinivasan Yes, the refractory business in India roughly about Rs.5,500 to rs.6,000 crores a year. We are not significant player at all, we are less than Rs.200 crores in this market. We did sell parts of our refractory business not only the castable business at Vizag to Vesuvias; we earlier sold even the electro cast business at Palakkad to SEPR. So about 10, 12 years back , the philosophy that we had at that point in time we thought refractories may not be a growth area to work on. So we had exited a few of our businesses. And then much later, we decided that look, that is a business that will be of significant importance to us primarily because India would produce more and more of steel and steel accounts for about 70% of the refractory requirements and that tends to be a local industry, it is not a industry which is serviced by global scale plants in many places, it tends to be a local industry. So we had to reiterate some of our wrong decisions and get back to it, we had some cooling period. So we couldn't do it dramatically, we did buy a small plant in Jabalpur and started with the castables once again and we've grown this business 25% CAGR for a few years now, and some of the decisions of buying the refractory part of the RHI business at Thukela also is strengthen this. The two technical tie ups with Sheffield and Anderman is also to strengthen it. The technology JV of CRIL at Cochin to produce specialty bubble refractory raw material is also to strengthen this vertical. So we have now made significant steps to catch up with this business, significant upside exists, but we are talking at a time when the entire industry is stressed, both in India and abroad.

Ravi Purohit: So the reason for my asking is in Abrasive we are fairly significant player, there are two large players in the Abrasive industry in the domestic market, and then there is the rest of the industry?

K Srinivasan Right.

Ravi Purohit: Whereas in refractory as of today**,** you already have fairly large MNC players well established in India right from Calderys to Vesuvius to Kurosaki to the domestic players like IFGL, so in that sense what really do you think is our competitive advantage to be even to compete in this market where you already have well established five, six players and where relationships tend to be sticky. So let's say for example if Vesuvius or Calderys are supplying to the top guys, that relationship tends to be sticky, it's not like a thing that tomorrow Vesuvius can be replaced by a Calderys, can be replaced by IFGL and so on and so forth, so in that sense what really is our competitive strength that you bring to the table which makes us to believe that we can compete and achieve significant share in this market over a period of time?

K Srinivasan Except the last name that you mentioned all the other four are Indian companies sold to international buyers, so which means really the Indian companies actually did not see a competitive advantage, and so most of them actually divested, they've all been bought over by international players. And which also says a little bit about where the competitor advantage lies. See, the three things I bring to the table, one is, unlike in global refractory businesses, Indian steel makers do not buy refractory, they want refractory management contracts. So you can't supply refractory, you will have to manage their refractory requirement, which is very unique to India, it's not a practice anywhere else in the world. That's a fundamental difference, so you need to get in the refractory management. The second thing is, all the international players are actually running plants which were started and were run by Indian companies, either they had a steel plant and so they started it, or they had a cement plant and started this refractory business. So it was actually a bolt-on to one of their core businesses. So that is how it came and eventually they divested to international companies. Now, the advantage that we bring to the table in our business compared to the others, and that's the reason why we said we have a unique strategic position to compete in this is we are the only person among all the names you mentioned, who make their own raw materials. Now, for us the advantage is it's my input, and input cost in refractories tends to be almost 60%. If I have a better handle on the input compared to anybody else, I would still be competitive, it also makes my mineral business more competitive because then I can use all the grades of minerals that I will anyway end up producing, rather then selling to on a disposal basis to an outside customer making refractories, I would rather consume it and make the delta myself. So it sort fits nicely with our philosophy being an end-to-end supplier, plus the advantage in India for us. Refractory we are not a global player, only looking at India as a market is that we have access to all these customers even otherwise. We go to all these customers for our ceramics, we go to these customers for our wear and corrosion products, which is the photovoltaic products, we got to them for the abrasives and the machines for grinding etc. So we are a complete package producer, so for us to break in and build market share is much easier, and to give you an example, see there is a relationship and that's the reason why we are able to build on, most of these steel guys the kind of growth we have seen in market share with them is phenomenal, they are not growing, they are all doing badly this year. But because of our relationship, we are able to take market share and grow very quickly. That will be an advantage. Lastly, These refractory names you mentioned are international, almost all the steel manufacturers in India are Indian. So I think India Carborundum has a better chance.

Operator Our next question is from the line of Bhalchandra Shinde from B&K Securities.

Bhalchandra Shinde Sir, I would like to know the current capacities segment wise, I mean like abrasives, bonded, coated or industrial ceramics refectory and what…

K Srinivasan Sridhar was always waiting for this question, now he is going to tell you the answer.

Sridharan Rangarajan Bhalchandra, actually generally again, we would not like to go through this in detail, but by and large we would give is that; abrasives by and large we would be operating at about 70%, 75%, and refractory again would be in the range of about somewhere in the range of 65% to 70% and industrial ceramics would be operating somewhere in the range of 80% in tiles and metalized would be in the range of about 70%.

Bhalchandra Shinde And sir the CAPEX which we are planning, how much capacity will be added to segment wise?

K Srinivasan This time, I think initially we also shared is not much capacity will be added this time. There will be some debottlenecking or some marginal capacity increase will be there, lot of that will be spent on the our maintenance CAPEX and capability building.

Operator Ladies and gentlemen that was the last question. I would now like to hand the floor back to Bhoomika Nair. Thank you and over to you, ma'am.

Bhoomika Nair Yes, thank you everyone for taking time out especially the management, and wishing everyone a very Happy Diwali.

Sridharan Rangarajan Thank you Bhoomika. Happy Diwali.

K Srinivasan Thank you Bhoomika. Happy Diwali to all of you once again. Thank you.

Operator Thank you, thank you members of the management. On behalf of IDFC Securities Limited, that concludes this conference call. Thank you for joining us and you may now disconnect your lines. Thank you.