DCM Shriram Ltd.

Q1 FY15 – Earnings conference call Transcript
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Moderator: Ladies and gentlemen, good day and welcome to the DCM Shriram Ltd.'s conference call. As a reminder all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing '*' then '0' on your Touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Ishan Selarka of CDR India. Thank you and over to you, sir.

Ishan Selarka: Good afternoon and thank you for joining us on DCM Shriram Ltd.'s Q1 FY15 earnings conference call. Today we have with us Mr. Ajay Shriram – Chairman & Senior Managing Director; Mr. Vikram Shriram – Vice Chairman & Managing Director; Mr. Ajit Shriram – Joint Managing Director and Mr. J. K. Jain – CFO of the Company. We will begin the call with opening remarks from Mr. Vikram Shriram and Mr. Ajit Shriram following which we will have an interactive question and answer session.

Before we begin please note that some of the statements made in this conference call may be forward looking in nature and a note to that effect was included in the conference call invite sent out to you earlier. I would now like to invite Mr. Vikram Shriram to give us a brief over view on the Company's operations for the quarter ended 30 June 2014 and the opportunities going forward. Over to you, sir.

Vikram Shriram: Thank you Ishan. Good afternoon ladies and gentlemen and a very warm welcome to DCM Shriram Ltd.'s Q1 FY15 earnings conference call. I will take this opportunity to share with you insights in to the Company's performance and plans following which Ajit will take you through the financial highlights of the Company for the quarter ended June 30, 2014.

We are pleased to report an encouraging performance in Q1. Almost all segments recorded improved performance over the same period last year. The sugar sector however, continues to operate in a difficult operating environment and continues to make net losses.

Let me now take you through the business wise highlights.

The Chloro-Vinyl business continues to deliver sustained performance backed by firm realizations. The prices of PVC have continued to move up while Chlor-Alkali prices have dropped since the last quarter. The margins continue to be healthy. The business is experiencing cost pressures in term of coal, salt, and freight. We continue to remain focused on optimizing our cost structure.

The Bioseed business is making good progress; the domestic operations registered strong volume growth in BT Cotton across all our markets, leading to a higher topline as well as bottom line. Our Cotton Seed products Yuva and Bindaas are gaining higher consumer acceptance and have recorded high growth over the last year in South and Central India. Delayed monsoons in South and Central India has impacted the performance of other field crops especially Corn. International operations are stabilizing with the increasing market penetration and product acceptance. Growth rates in the medium to long term are expected to be robust driven by products launched in the last one or two years especially Yuva and Bindaas, a healthy product pipeline and a continued focus on R&D.

The performance of the Farm Solutions business was impacted due to weak monsoons. This led to a slower growth of value-added inputs portfolio; while seeds did well, other products had a lower off take. The bulk Fertilizers also experienced lower sales due to delayed monsoons. Delays in subsidy payment continues to be a concern area. We are focusing on expanding the product range in the value added segments combined with increasing geographical reach, which is expected to drive growth in the medium term.

The Sugar business continues to operate in a challenging environment impacting the farmer as well as the industry. Low sugar prices and high cane costs led to negative net margins. It is now imperative to have a cane pricing policy, which links the cane price to the sugar price to improve the fundamentals of the industry. The stress faced by the industry and farmers together has led to a reduction in area under cane cultivation for the coming season, besides creating working capital problems for the industry.

The Urea business continues to be adversely affected due to delay in subsidy payments and inadequate compensation for the conversion cost increases over the last decade. The government as a partial relief has increased conversion cost reimbursements by Rs. 500 per ton with effect from 1st April 2014. However, a rational long-term policy is an urgent need for the sector.

The performance of Fenesta Building Systems is stable; thrust is on strengthening the retail business through the expansion of the direct sales network, own showrooms, optimization of dealer network and intensive sales promotion. These efforts should deliver substantial growth over the medium term onwards.

In Q1, the Company sold a textile unit for the consideration of Rs. 17.1 crore at a marginal gain over book value. The JV with Axiall Corporation for PVC compounding business under the name Shriram Axiall Private Ltd. operationalized in Q1 FY15. This is expected to deliver better value to our PVC compounding business going forward.

We remain focused on keeping our balance sheet strong. The debt levels have come down significantly and we expect to sustain these levels. Our balance sheet strength and healthy cash flows have laid the foundation for future growth. We are now expanding and upgrading our co-gen capabilities at a CAPEX of

Rs. 125 crore in sugar, which is expected to be commissioned by November 2015. We are also evaluating other investment options within our businesses to deliver higher growth over the medium term. I would now request Ajit to take you through the financial highlights.

Ajit Shriram: Thank you. Good afternoon ladies and gentlemen. I will now summarize the financial results for Q1 FY15.

Total revenues for the quarter were higher by 9% at Rs. 1,704 crore compared to Rs. 1,561 crore last year. PBDIT at Rs. 269 crore was up by 34% over last year. Net profit stood at Rs. 177 crore up 56% compared to the corresponding quarter last year.

Let me now take you through our business wise financials.

Chloro Vinyl business revenues stood at Rs. 359 crore and PBIT at Rs. 113 crore. Both Chlor-Alkali and PVC recorded a price increase of 16% and 20% respectively during the quarter vis-à-vis Q1 FY14. However, on a sequential basis the Chlor-Alkali prices have declined by 9%.

The revenues from the Fertilizer business were up 18% for the quarter driven by higher natural gas prices purchased on spot basis due to lower supply of Reliance gas. PBIT for the quarter stood at Rs. 11 crore vis-à-vis Rs. 7 crore in the same period last year. Earnings reflect increase in reimbursement towards conversion costs under NPS III by Rs. 500 per ton w.e.f. April 1, 2014. High subsidy outstanding has led to a higher capital employed and borrowing cost for this business. However, loans against subsidy with interest subvention partly moderated the impact.

Shriram Farms Solution business revenues during Q1 stood at Rs. 449 crore compared to Rs. 464 crore last year. The decline was driven by SSP, whose sales volumes declined by 24% during the period. The revenues of valued-added inputs grew by 3.5% due to delayed monsoons. One-time fixed expenses impacted earnings and resultantly PBIT was marginally lower at Rs. 21 crore.

The revenues from Bioseeds business during the quarter grew by 37% to Rs. 395 crore vs. Rs. 289 crore in the same period last year. PBIT improved by 45% to Rs. 95 crore as compared to Rs. 66 crore last year. The Indian business registered a 26% growth in turnover and 29% increase in profit in Q1. BT cotton volumes for the season grew 63% with stronger performance in South and Central India. The international business in Vietnam and Philippines post one-time sales return an inventory write-offs during last year are now positive at the operating level.

Sugar business revenues in Q1 were lower by 17% at Rs. 281 crore primarily due to lower sugar sale. PBIT stood at Rs. 8 crore vis-à-vis a loss of rupees Rs. 1 crore last year. Sugar margins are negative at net level although the gap has narrowed consequent to lower cost of production due to higher recovery in sugar season 13-14.

The revenues and PBIT in the cement business stood at Rs. 37 crore and Rs. 5 Crore respectively. Earnings reflect the impact of better realization, volumes, and higher input costs.

Revenues under the Other segment in Q1 stood at Rs. 65 crore and PBIT at negative Rs. 2 crore. Fenesta witnessed improved revenues as well as the order booking in retail segment. However, institutional sales are lower. During the quarter the Company sold its textile business for a consideration of Rs. 17.1 crore.

The Company's finance cost for the quarter at Rs. 28 crore were lower by 36% over last year driven by lower borrowings. Net debt stood at Rs. 825 crore as compared to Rs. 1,637 crore in June 2013. Healthy cash flow generation over the period has enabled us to reduce debt and strengthen the overall financial position. Our balance sheet remains strong and we plan to consolidate the same at these levels.

That concludes my financial review and we would be glad to take any questions that you may have.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question and answer session. Our first question is from Niket Shah of Motilal Oswal Securities. Please go ahead.

Niket Shah: What kind of sales return have you accounted for in the Bioseeds business in the current year vis-à-vis same quarter last year?

J. K. Jain: Overall sales return on an average should be about 10%. Sales return in North during the last year were higher at about 20% to 25%.

Niket Shah: So we would have seen an improvement in sales return over last year?

J. K. Jain: Absolutely.

Niket Shah: Is that one of the primary reasons for improvement in margins?

J. K. Jain: The turnover improved, but the margins in cotton have not gone up compared to last year.

Moderator: Thank you. Our next question is from Nitin Gosar of Religare Invesco. Please go ahead.

Nitin Gosar: Sir, I will appreciate if you could help us understand your competitive positioning in the Chemicals and PVC businesses. Also how competitive are you vis-à-vis imported chemicals/PVC products at the current rupee-dollar rates?

Ajay Shriram: We are the third largest producers of Chlor-Alkali in the country. In PVC we use the calcium carbide route so with that sort of an approach we have not looking at expanding our PVC business but we are looking at value added on PVC resins which are moving through our joint venture with Axiall for compounds and Fenesta for our windows.

Going forward, if the GDP growth in the country picks up I think that will give the chemical business a fillip in terms of demand going up. India is cost competitive and our focus has been on reducing our cost of production because that is how we can compete in a commodity on a world scale. We are not seeing any major problems in the near future. In America, the only issue is of Shale gas that has come in. With that, their energy cost should be lower but then there are the issues of freight, etc. coming here.

Based on the supply demand position over the last few years, our estimate for the next few years is that we should have a fairly stable position on the Chlor-Alkali business. In terms of PVC, India even today imports almost 50% of its requirements. The capacity expansions are not happening in India. Therefore, with that sort of a situation, we think PVC will also be on a sound footing. The dollar-rupee will be at about Rs. 60 to the dollar based on our estimate and our discussion in CII meeting. If that is the case then we should be fairly competitive in India.

Nitin Gosar: Does dollar depreciation affect you in this business?

Ajay Shriram: Frankly, it does lower landed cost of imported products thereby resulting in pricing pressures. But depreciation in dollar also decreases a certain percentage of our cost of raw materials viz. coal and oil.

Moderator: Thank you. Our next question is from Dheeresh Pathak of Goldman Sachs. Please go ahead.

Dheeresh Pathak: What is the capacity utilization in Chlor-Alkali, PVC and Carbide?

J. K. Jain: Our capacity for Chlor-Alkali is about 765 TPD operating for almost 350 days. For PVC, our capacity is about 180 TPD again which is utilized for 345 to 350 days in a year.

Dheeresh Pathak: Does PVC include Carbide as well?

J. K. Jain: Carbide is largely used for PVC, so it is captive consumption. We also sell about 2,000 to 2,500 tons a month in the market.

Dheeresh Pathak: In Bioseeds, have we sold about 45 to 50 lakhs packets of cotton this year?

J. K. Jain: No, we are expecting sales of around 44 lakhs packet on a Kharif basis. In Kharif 2014, we are expecting to sell about 44 lakh packets compared to 27 lakh packets sold last year.

Dheeresh Pathak: But the bulk of these sales would have happened in this quarter?

J. K. Jain: Yes, except about 10% or so that happened in March 2014.

Dheeresh Pathak: Can you just give a sense of the growth in South and what is the competition landscape in South now?

J. K. Jain: It is a little early to give those numbers. I think those will come by July end or August. But, we have grown both, in North as well as South. In South, we have started with a small base therefore the growth is larger. In North, we are the leaders therefore growth in percentage terms is slower.

Dheeresh Pathak: Could you throw some color on corn?

J. K. Jain: Corn is about 20% of domestic turnover; corn is facing challenge this year as the overall area has gone down and people are shifting from hybrid to variety seeds because of the monsoon pressure. So, the hybrid market will go down drastically. We are also expecting about 25% drop in corn turnover compared to last year.

Dheeresh Pathak: But this would be unlike Monsanto, which reported good numbers in corn. So what would be the reason for the leaders reporting growth and we expecting de-growth in corn?

J. K. Jain: I do not have Monsanto's number. Our estimates are based on the statistics that we have. The overall country is expecting area under corn to go down. Therefore, the overall market has to go down just because of area. In addition, as I mentioned there is a trend to adopt more variety compared to hybrids because when the monsoon is less, the farmer shifts to variety seed. Therefore, the overall market will go down. Now which player gets affected by how much will be known in due course of time.

Moderator: Thank you. Our next question is from Chetan Thacker of Emkay Global. Please go ahead.

Chetan Thacker: Have we seen any movement on the sugar policy in UP? What is the outlook there because it continues to remain very challenging. Do you believe that there will be linking similar to what happened in Karnataka or you think it would be postponed again?

Ajit Shriram: As far as sugar is concerned, the UP government had formed a committee to look at the linkage formula and this committee was supposed to have given their recommendation by 30th of April. Now that has not come yet and we are constantly in dialogue with the government to ask them to come out with the recommendations as soon as possible. That is the status as far as the cane linkage formula is concerned for UP.

Chetan Thacker: Would a price of Rs. 235 to 240 per quintal be acceptable to the industry?

Ajit Shriram: If we go strictly by the formula, the average sugar realization this year will be in the range of Rs. 30 to 31 and 75% of that does come to Rs. 235 to 240.

Chetan Thacker: So we still have to wait and see what unfolds there from the UP governments.

Ajit Shriram: Yes, we are hopeful that something positive comes out fast because the season is approaching now and we need to come out with a rational policy.

Chetan Thacker: What are the arrears? Also, how much is the acreage likely to go down this year in UP in cane?

Ajit Shriram: It is difficult to give the acreage number immediately. The acreage may have come down by about 7-8%. However, the yields may be better this year compared to last year because last year we had prolonged rain. So it is a little early to comment on acreage in quantum right now but I think as the monsoon progresses we will get to know better. In terms of arrears, it is at about Rs. 5,000 - 5,500 crore at this point in time.

Chetan Thacker: What is your average coal cost for the current quarter vis-à-vis last quarter?

J. K. Jain: We do not have the coal cost currently. Nevertheless, the power cost for Kota is largely a reflection of coal cost, which has gone up by about 20% over last year. This is not only because of coal cost increase it also factors in the freight increase. For our Bharuch factory, it has gone up by 3-4% as we use imported coal there.

Chetan Thacker: Is the freight increase largely because of the railway freight increases, which have taken place?

J. K. Jain: Yes.

Moderator: Thank you. Our next question is from Siddharth Mohta of Principal India. Please go ahead.

Siddharth Mohta: You mentioned that you sold 27 lakh cotton packets last year; so is it Q1 & Q2 put together? Did you mention that this year that figure should be 44 lakh packets?

J. K. Jain: Yes. From Kharif 2013 to Kharif 2014, the total sales have gone up from 27 lakh to 44 lakh packets. Last year the entire 27 lakhs was sold in Q1 only. This year out of 44 lakh, about 10% was sold in Q4 last year and about 5% will be sold in Q2.

Siddharth Mohta: That is in the month of July.

J. K. Jain: Correct.

Siddharth Mohta: You said that last time we had a sales return of around 25% in North, which was 10% this time? Is there any particular reason for that?

J. K. Jain: No. The overall demand for cotton seed has been good this year and our product has done better than the industry.

Siddharth Mohta: Could you quantify sales for Yuva and Bindaas?

J. K. Jain: It will be difficult to give a product-wise breakup currently because we are still in the process of finalizing the sales and sales return. That will come by Q2.

Siddharth Mohta: What was the quantum of one-time expense under Shriram Farm Solutions?

J. K. Jain: About Rs. 5 crore.

Siddharth Mohta: Globally, caustic soda price in July was a little softer. Are we witnessing similar trends in India as well?

Ajay Shriram: Yes, the prices have come down and they were little softer; but PVC prices were stronger. I think we just match the international price with delivered cost basis. And I think the industry takes a view because now the imported material does come in.

Siddharth Mohta: So can one assume that for rest of for the year, PVC price would be around Rs. 75,000 per ton realization?

Ajay Shriram: It is difficult to give a figure. However, we do not expect it to fall too much.

Siddharth Mohta: Is the situation similar for the chemical segment?

Ajay Shriram: There is a possibility of Chemical realizations fluctuating by a couple of Rs. 1,000 a ton.

Moderator: Thank you. Our next question is from Paresh Jain of Max Life. Please go ahead.

Paresh Jain: Could you throw some color on your CAPEX plans?

Ajay Shriram: As we mentioned a little earlier, we are looking at augmenting our co-generation power capacity in two of our plants and are planning to invest about Rs. 125 crore for upgrading and increasing our co-gen capacity to sell more in the market as well as to improve the efficiency of the entire steam system. Secondly, on an annual basis, we spend about Rs. 55 crore to Rs. 60 crore that is required as an ongoing CAPEX expenditure to maintain our plant and equipment in healthy condition. Additionally, we are also looking at other proposals but nothing has been finalized yet.

Paresh Jain: What is the co-gen capacity that is being put up?

Ajay Shriram: We are getting about 17.5 MW of additional power available through the co-gen system and we are upgrading our boilers and turbines from 45 kg steam boiler to 110 kg steam boiler. So, the efficiency of the system goes up and hence this 17.5 MW is at a very low cost. It is a long-term benefit, which the Company will get.

Moderator: Thank you. Our next question is from Rohan Gupta of Emkay Global Financial. Please go ahead.

Rohan Gupta: What growth should one expect in current year from the Farm Solution business?

Ajay Shriram: It will be dependent on how the monsoon moves forward.

Rohan Gupta: If I exclude the bulk fertilisers?

Ajay Shriram: On the value-added area i.e. seeds and other things, we expect a growth of 15 to 20% to happen.

Rohan Gupta: With the continuous improvement in product mix in that segment, do we expect further expansion in margins in the current year?

Ajay Shriram: I do not think margins will get too of advantage. We expect the volumes to go up plus we are continuously looking the new products that can be introduced to the farmers. We believe that should give us the advantage.

Rohan Gupta: Can we quantify the revenues from North & South in the Farm Solution business? What is the scope for further penetration in the South market?

J. K. Jain: In Farm Solutions, we do not have any significant presence in South. Almost 80% comes from North and 10 to 15% comes from let us say Maharashtra, Central and West essentially.

Rohan Gupta: With a decent performance of our Bioseeds products in the South market, do we have any plans for aggressive entry in Farm Solution in the Southern market, which can give a good boost to our revenue in Farm Solutions? Do you have any strategy in place so far now?

Ajay Shriram: We are in fact looking at expanding the markets in a phased way wherever you find we have the market potential and where we have some presence because we feel the intensity of activity in an existing market can also go up. Besides, we are looking at new markets. It is a two-pronged approach. One is how we can provide better product services through a more elaborate retail and distribution network to have a deeper sense of penetration in the existing markets and secondly look at the new markets where there is potential. We are focusing on both.

Rohan Gupta: Farm Solutions business has presence almost across the segment i.e. seeds to Fertilizers to many inputs, but you do not have any facility in agro chemical. That is probably the missing link. So with the significant cash flow generation now do you have any plans in organic growth opportunities in agro chemical business in India?

Ajay Shriram: We have studied the crop care protection chemicals as a vertical and as a business. We have also got some study done by McKinsey on this to see what is the future strategic direction for the business. We are in dialogue with them to see how we want to carry forward this business and what are the growth avenues in this business? Crop care protection chemicals is one of them definitely. We are studying all the avenues currently, but have not frozen on anything yet.

Rohan Gupta: So may be an inorganic opportunity in agro chemical business cannot be ruled out given that Company has huge cash flow generation?

Ajay Shriram: As I mentioned we are still studying it. I think we have to take a management decision of what is the strategic direction we want to invest in and grow in and I think this is an ongoing activity. I am sure we will have more information by the next quarter and we will be in a better position to share a more concrete plan.

Moderator: Thank you. Our next question is a follow up from Chetan Thakkar of Emkay Global. Please go ahead.

Chetan Thacker: With what kind of debt would we be comfortable in terms of capital structure?

J. K. Jain: We generally aim at two times the average desirable EBITDA. We feel that our average EBITDA range is Rs. 500 crore to Rs. 550 crore and hence we are comfortable with debt of about Rs. 1,000-1,100 crore. This is on the present sugar conditions. If there is some fundamental change in sugar conditions, then the debt raising capacity and the investments can go up.

Chetan Thacker: So even though you will be generating free cash, you would still be keeping approximately Rs. 800 crore on the books?

J. K. Jain: There may be year-to-year variation in that, but on an average level we are comfortable with around Rs. 1,000 crore debt.

Moderator: Thank you. Our next question is from Dheeresh Pathak of Goldman Sachs. Please go ahead.

Dheeresh Pathak: Just want to understand the chemical business in terms of the growth in the revenue in this segment. Based on the capacity numbers that you gave, it seems that a lot of the three buckets are fairly utilized. If I understood you correctly, you said that in the PVC space you are not looking to add more capacity because we do it from calcium carbide route unlike the other players who might do it from the petchem route. So, if we are not adding capacities in PVC and calcium carbide then the revenue growth will be a function of realization growth which will be dependent on the supply-demand scenario. Any color that you would like to give on the growth in Caustic Soda?

Ajay Shriram: Well, as we mentioned earlier we are looking at growth avenues, which can add value to the Company and last year we added one electrolyzer, which gives us the advantage of actually reducing our power consumption. So the cost of production comes down and the margins go up. We are studying various options. I think we will be in a better position may be after couple of months' time.

Dheeresh Pathak: Which could also include expansion in this because I just want to understand that within caustic soda would be a capacity, which is on historical cost and enjoys more vertical integration and better return profile. So given the current market conditions, is it possible to add or commit more capital to caustic soda business so that it can generate attractive returns on yield and CAPEX?

Ajay Shriram: I think you are right. We are looking at growing many businesses. We feel our Bioseed, and Chlor-Alkali businesses can grow. That is also very much on the agenda of our discussion to see where all we want to grow and which verticals we want to take forward and within timeframe.

Dheeresh Pathak: What is the competition like in Chlor-Alkali business?

Ajay Shriram: There are many players. I think largest would be Gujarat Alkali and Chemicals Ltd. and then there is the Aditya Birla Group. I think these are the two larger than us. The Western and Southern regions in India have a larger concentration of manufacturing capacities. In the Northern region there used to be Modi Alkalies which is closed now there is one plant in Ropar which is running and then we are there in Kota. So, the West and South is where really there is a larger concentration of capacity.

Dheeresh Pathak: What is the consumption pattern? Is India a net importer or we also export?

Ajay Shriram: India does import but imports may be about 7-8% of the annual production over here and it is more of actual users who imports so they get the benefit of the duties, etc. But, there has been some imports in terms of flakes & lye both.

Moderator: We have a follow up question from Siddharth Mohta of Principal India. Please go ahead.

Siddharth Mohta: Any update on our lignite mines in Rajasthan.

Ajay Shriram: Well, we have purchased approximately 50% of the land which is required for this but the discussions on the new land law which started about three years ago consequent to that there is no one who is a seller of land. So, that has got stuck. Our permissions and applications are pending with the State Government in Rajasthan and that is moving. We are reviewing that to see how the economics will actually work out based on the new prices of land. I think that is going to be a crucial factor, which is going to impact the economics of this proposal.

Siddharth Mohta: But can we assume that for the coming six to eight months nothing much will happen as far as this is concerned?

Ajay Shriram: No, in the next six to eight months we will not be in a position to get any benefit out of this.

Moderator: Thank you. As there are no further questions from the participants, I now hand the floor back to the management for closing comments.

Ajay Shriram: Thank you very much. I think overall our performance has been encouraging barring the sugar segment and we are confident of achieving good operating performance across all our businesses going forward. Some of our businesses like Bioseeds, Shriram Farm Solutions and sugar have an element of seasonality in their performance. Profitable growth driven by operating efficiencies and improved cash flows will continue to be our focus in the year ahead and will drive superior performance going forward. As stated earlier, we will look at the investment opportunities within all our businesses to deliver better returns within the ambit of a strong balance sheet. Ladies and gentlemen, thank you once again for being with us on our concall today. Thank you and good bye.

Moderator: Thank you. Ladies and gentlemen, on behalf of DCM Shriram Ltd. that concludes this conference. Thank you for joining us and you may now disconnect your lines.
