DCM Shriram Limited
Q1 FY20 Earnings Conference Call
August 02, 2019

Moderator: Ladies and gentlemen, good day, and Welcome to the DCM Shriram Limited Q1 FY'20 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Siddharth Rangnekar from CDR India. Thank you and over to you, sir.

Siddharth Rangnekar: Thank you. Good afternoon and thank you for joining us on DCM Shriram Limited's Q1 FY'20 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; Mr. K.K. Kaul – Wholetime Director and Mr. J.K. Jain – CFO of the Company.

We will begin the call with "Opening Remarks from Mr. Ajay Shriram and Mr. Vikram Shriram", following which we will have an "Interactive Question and Answer Session."

Before we begin, please note that some of the statements made on today's call could be forward-looking in nature and a note to that effect has been included in the 'Conference Call Invite' circulated earlier.

I would now like to invite Mr. Ajay Shriram to give us a Brief Overview on the Company's Performance during Q1 FY20 and his views going forward. Over to you, Sir

Ajay Shriram: Thank You. Good Afternoon Ladies & Gentlemen and thank you for joining us on our earnings conference call to discuss the performance of Q1 FY20. I will share my thoughts on the developments in our businesses during the quarter and the opportunities that lie ahead of us. Vikram will follow up with key highlights of the financial performance of the Company.

We have reported satisfactory performance during the first quarter of FY 2019-20. PBDIT grew by 8% & PAT by 1%.

We are committed to strategic capital expenditure programme to build scale, achieve better efficiencies and integrations over a period of time. We have implemented projects at approximately Rs 1,500 crores during April 2017 to April 2019. Projects involving investments of Rs. 1,642 crores are under implementation. All these projects are progressing as per plan. The management is contemplating entering Chlorine downstream businesses which will also lead to higher captive consumption of chlorine.

Let me now take you through the business wise developments:

Chloro-Vinyl

This segment includes our Chemicals & Plastics businesses. Regarding Chemicals, the Indian market witnessed firm caustic and chlorine prices over the past few quarters. However, the prices have started softening from May '19 onwards. The domestic caustic prices that were ruling at a premium over imports parity prices, have seen a correction over last 2 months.

Prices of caustic soda (lye) are expected to remain soft in western and southern region owing to reduced consumption from the downstream players coupled with ample supply in the market partly due to increase in imports. Chlorine prices also witnessed a decline as incremental supply outpaced demand growth.

Q1 FY20 saw our effective capacity utilizations going up by 31% YoY, following commissioning of 500 TPD additional chlor-alkali capacity between Sep'18 to April'19. This includes a capacity of 332 TPD at our Bharuch facility that became operational in April 2019. However, this capacity of 332 TPD has been utilized to the extent of ~45% in Q1 FY 20 due to the softening of demand of both Caustic Soda and Chlorine. We expect the capacity utilization to gradually increase as the demand starts recovering.

Plastics:
We continue to see moderated demand for PVC on account of sluggish requirement in end user industries. The long-term scenario remains positive and will move in line with GDP growth . The increase in Government spending post budget is also likely to help in boosting domestic demand.

Domestic prices continue to follow global trends, which are trending softer in the recent few months. Basic custom duty on imported PVC has been revised upwards with effect of 6th July, 2019. Since the announcement, the domestic PVC prices have already marginally risen over the last 2 weeks. We expect this positive impact on domestic prices to continue going forward.

Sugar:

Total acreage under sugarcane is estimated to be around 49.3 lac hectares in sugar season 2019-20 which is 10% lower than sugar season 2018-19. Uttar Pradesh, the leading sugarcane and sugar producing state in the country, is estimated to have sugarcane area of about 23.6 lac hectares, as against 24.1 lac hectares in sugar season 2018-19. Sugar Season 2019-20 is likely to see sugar production in UP mills at similar levels of the last season, which stands at 118 lac tonnes.
The sugar production at an All-India level during sugar season 2019-20 is estimated to be around 280 lac tonnes against a production of 330 lac tonnes in sugar season 2018-19. Despite the expected lower production of 50 lac tons, the supply overhang situation is likely to persist in sugar season 2019-20 given the sugar season 2019-20 opening stock of 142 lac tons and an estimated domestic consumption of around 260 lac tons.

The Central Government's release mechanism that is in place and the announcement of the creation of a buffer stock of 40 lac tons of Sugar may help support stability in sugar prices. The government will provide for the carrying cost of this buffer stock. The government also decided not to increase FRP for sugarcane from the current levels.

Approximately 32 Lac tonne of exports have been contracted till now for sugar season 2018-19 and this may go up to 40 lac tonnes by end of the current season. The industry is pursuing with the Government for continuing the exports policy for the sugar season 2019-20 so as to deal with the supply overhang. The Government continues its policy of 10% blending of ethanol and support for production of Ethanol through B-Heavy Molasses and Cane Juice routes. This is likely to help sustain the growth of domestic Ethanol production.

Our existing 150 KLD Ethanol distillery has operated at full of capacity during the quarter. Our new 200 KLD distillery is expected to come on stream during the new sugar season and we expect to operate the both the distilleries at full capacity. We intend to divert approximately 8-10% of sugar production towards ethanol through B-heavy route.

Urea:
As you are aware, the existing urea policy stands extended till the new policy takes its place. We expect a fair and reasonable policy in next few months. Our Urea plant had a shut down in March-April'19, which happens once every two years. Now the plant is running in stable way.

Bioseed:
International business saw more product acceptance in corn. As you are aware India operations are heavily dependent on monsoons. The delayed and erratic monsoon has caused a delay in sowing of most crops. This has led to part deferring of revenues to Q2. The industry continues to witness challenging scenario in the absence of new technologies and new product approvals. Maize and Paddy continue to offer opportunities in the interim. We have a dedicated research program in place and continue to develop varieties in key crops including cotton, maize, paddy and vegetables and aim to achieve growth in the medium to longer term.

Shriram Farm Solutions:
Our strategy of focusing on value added inputs segment within SFS continues with revenue increasing to Rs. 166 cr in Q1 FY 20 against Rs. 157 cr in the same period last year. We are also continuing our effort to introduce newer generation and differentiated products through strategic alliances.

Fenesta:
We are seeing healthy growth in the Fenesta business in both retail and project segments. We are adding new products into our range of offering while also increasing our footprint geographically. The objective is to achievehigher growth through these initiatives.

Other Businesses:

Our Cement business, essentially supports the Chlor-Vinyl operations by consuming the sludge generated in the process of producing Acetylene, which is the raw material for our PVC production. We operated our Cement plant at full capacity during Q1 FY 20, producing 1.12 lac tons of Cement. The strong demand growth for Cement has helped us realise 16% higher prices in Q1 FY 20 over Q4 FY19. We expect the demand to remain firm during the year.

Shriram Axiall is our 50:50 JV in the PVC Polymer compounding business with Westlake, USA. We continue to focus on serving the demand of higher value downstream segments of auto, medical etc, helping us increase our revenues by 18% and an increase in contribution by 37% YoY for the quarter.

Overall, we are on schedule with plans to further strengthen our businesses through capacity augmentation and improvement in cost structure in order to drive sustained earnings growth.

I would now request Vikram to share his perspectives with you.

Vikram Shriram: Thank You. A very good afternoon Ladies & Gentlemen. I shall take you through the financial highlights for Q1 FY20.

Overall revenues stood at Rs.1,902 crores down 8%. The business-wise movement is as follows:

- Revenues in Chemicals stood 18% higher YoY backed by 22% gains in volumes consequent to new capacities addition.
- Fenesta revenues up by 17% YoY driven by both retail and projects.
- Revenues from Sugar lower by 22% YoY at Rs. 482 crores due to lower domestic sugar volumes by 36% YoY, resulting from sale release mechanism imposed by GOI from June 18 onwards and lower power volumes due to lower season days in Q1 FY20 vs Q1 FY19. Distillery contributed to higher revenues with higher volumes.

The PBDIT for the period was 8% higher at Rs 374 crores. The growth in PBDIT was driven by:

- PBDIT of Rs. 270 crores from Chemicals business up 3% YoY.
- PBDIT of Rs. 87 crores from overall sugar business as compared to Rs. 7 crores in the comparable quarter last year led by better sugar realizations and higher profits from Distillery.
- PBDIT increase in Bioseed International operations and Fenesta business.

PAT came in at Rs 221 crores during the quarter vs Rs 218 crores during same period last year.

Cash generated during the present quarter is Rs 295 crores vs Rs 138 crores in Q1 FY19, that was utilized for CAPEX to the extent of Rs. 216 Cr and a Net Debt reduction of Rs. 79 Cr.

Net Debt as at June 30, 2019 stood at Rs. 1,186 crores. Corresponding figure as at 31st March, 2019 was 1,265 crores.

The Net Debt to EBITDA (calculated on TTM basis) stood at 0.80, almost the same as at March 19. We endeavor to phase our investments to keep the ratio under a prudent level at all times.

Capital Employed (excluding CWIP) as at 30th June, 2019 increased 22% YoY (5% QoQ) on account of higher capital employed in Sugar and Chloro-Vinyl segments.
Sugar segment capital employed stood at Rs 2,028 crore, higher by 86% YoY due to increase in fixed assets consequent to new plants commissioned, higher stock and lower cane dues.

Chloro-vinyl capital employed stood at Rs 1,247 crores, up 20% pursuant with increase in fixed assets due to new capacities additions in chemicals.
Higher capacities and greater integration achieved through expansion initiatives in chemicals and sugar segments continues to result in higher profitability. Our return on capital employed [on Trailing Twelve Months (TTM) basis] as at June 30, 2019 stood at 28.6% as compared to 24.6% for the same period last year and 29.9% for FY19.

Projects
We are implementing projects in Chlor-Vinyl & Sugar businesses involving total investments of Rs. 1,642 crores. These are progressing well as per plan. These projects will enhance scale in key businesses and are intended to further strengthen our cost competitiveness and cost structures.

We will finance these projects mainly through internal accruals with only small increase in debt.

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

Moderator: Sure. Thank you very much. We will now begin with the question-and-answer session. The first question is from the line of Pratik Tholiya from Elara Capital. Please go ahead.

Pratik Tholiya: Sir, in the opening remarks, you mentioned about chlorine downstream project. We have been hearing this for almost three, four quarters now. So, would it be possible for you to give some more color on the same in terms of what sort of products you are looking at and what could be the scale and size of this project or what sort of Capex you are planning to deploy for this and also how much of your chlorine currently that you are producing will get consumed in this downstream project?

Ajay Shriram: It is a very important question. You are right, we have been discussing this point and we have a couple of consultants who are helping us also study the situation and we have not yet taken a firm view on what exactly they are going to get into because we are studying all options and we are trying to devise a strategy of getting into the business and growing it for the next five years and ten years, it is not a short-term thing. So, it will be difficult right now to give details of where we are looking at because we are studying all alternatives and chlorine consumption we do want it to be the prime driver because our Chlor-Vinyl capacity in Gujarat as well as in Kota has increased. But it is too premature to give any figures of what is the sort of chlorine which will get into this project.

Pratik Tholiya: Any ballpark number, at least 50% chlorine along with the incremental capacity that will come up at least you are targeting to consume 50% of that or it would be more, something on that front?

Ajay Shriram: It is very difficult to give a number because there are options, for instance, we might look at a grassroots plant and build it up, we might look at taking over some plants and we move directly. So there are so many alternatives. Giving a number of how much chlorine will go and then what is it today, when we get into the business, what is it two years after that, what is it four years after that, all these things, it is very difficult and most important is we have to get first the feel of what is the chlorine downstream business we are getting into. So, I think it is little premature at the moment.

JK Jain: Pratik, you are aware, we also supply 35- 40% in pipeline from Bharuch to dedicated customer.

Pratik Tholiya: So, whatever the new plant, will it only the remaining chlorine that will get consumed or you will have to then curtail out current supplies to the current consumers and we will divert that for our internal consumption?

Ajay Shriram: As you are aware and we have announced it even earlier that we are expanding our Bharuch capacity by 700 tons per day additional production, which should be commissioned by March 2021. So, I think with 700 tons a day and if closing comes at 0.88x, which is 620 tons a day of chlorine, we have enough chlorine. I do not think that is the issue. The issue is going to be really what is the business of value add we are getting into and then we will see how things are going.

Pratik Tholiya: Has the chlorine prices corrected in last one month or so, what are the chlorine prices currently if you could just give some numbers on that?

Ajay Shriram: Because of the pressure over the last couple of months as I mentioned earlier that there is a pressure in the market and prices have come down, but we expect this to be a stabilization area now after what has come in and the chlorine prices as of now, the international ECUs also have dropped by about $100. So, I think that impact we are seeing in the Indian market also. And we are working with customers across the board to see how we can optimize and get a better realization.

Pratik Tholiya: Anyway, second quarter is typically weak in terms of the ECU realization if you see historically. So, is it seasonality that is causing this weakness or you see the structural slowdown which is causing the sort of weakness in ECU realizations?

Ajay Shriram: One cannot deny the fact that the demand has come down and I think that is impacting the offtake of caustic soda and chlorine, and also there is an additional capacity which has come into the industry here. The imports have gone up also because Japan has started exporting, China is exporting, so now material is coming in and lot of the aluminum people are importing caustic soda at a lower price because it is available in the international market at a lower price. So, there is a pressure on the prices across the board internationally which is impacting India also.

Pratik Tholiya: Just on the sugar bit, earlier in your presentation you were giving the revenue and PBIT for your power, distillery separately. Would it be possible to share those numbers for Q1 FY'20 again?

JK Jain: Pratik, I think we had explained also that revenue or profitability of power and distillery gets affected by transfer pricing which vary. So, we thought instead of getting it affected by accounting reasons, what matters is the total thing which is what we are reporting now, and that would be the practice we will continue going forward.

Moderator: Thank you. The next question is from the line of Rohit Nagraj from Sunidhi Securities. Please go ahead.

Rohit Nagraj: I have again same question on caustic soda. You said that demand is pretty soft which you have seen in the last couple of months. However, we have grown by about 20% in terms of volumes on YoY basis. So, do you foresee any volume decrease in the second quarter because of the softer demand?

Ajay Shriram: I will be honest with you. As we said that the demand is softening, international prices have fallen and for a commodity it is very difficult to give a projection of what is going to happen. But I think we are now more in the stabilization phase of what the prices look like. Margin up and down always happens in commodity. But I think we are at the stabilization phase now for the ECU.

Rohit Nagraj: Similar question for PVC as well, those volumes have remained flattish on YoY basis, so prices have been down. So, what is our thought process on the PVC side on prices and volumes?

Ajay Shriram: I think our volumes are quite the same. We have not had any else. As you are aware, we mentioned earlier we are increasing our PVC capacity by about 40 tons a day. So that will be commissioned in another three months' time. At the same time with the budget there was a 2.5% increase in the import duty of PVC which is being factored in and there has been a marginal increase in the price in the market in India. So that is a positive sign and we expect that increase in price to continue.

Rohit Nagraj: On the Bioseed business we have seen lower volumes due to BT Cotton, but have we seen any kind of uptick in the month of July when the rains I think have been relatively better?

JK Jain: Overall in India Cotton is not going up and therefore the situation continues as it was in Q1. We have not seen any significant jump in volumes in the July period.

Moderator: Thank you. The next question is from the line of Saket Kapoor from Kapoor & Company. Please go ahead.

Saket Kapoor: Sorry sir, I joined late in the call, so I missed your initial commentary. Sir, if you could just brief us about the caustic soda market and the reason for this decline in realization, what factor that actually playing out in the market?

Ajay Shriram: Saket, it is unfortunate you missed out. While we mentioned, the market has got softened over the last couple of months and we expect it to be a stabilization period now, international prices have also fallen, imports also coming in, so we expect this now to stabilize going forward.

Saket Kapoor: If we take the realization, it has remained almost at the level which it was last year first quarter. But your graph on 'Page #11 Investor Presentation 'shows a steep decline from the month of April at Rs.38,294 to Rs.31,359. So is it the downstream product that have contributed to keeping up the realization because caustic soda prices are down to I think Rs.31,359 in the month of June?

JK Jain: This Rs.31,359 is the ECU which includes caustic and chlorine both; Both of them saw corrections after peaking out in April. May was also down and June went further down. That's the period when actually the correction both globally and domestically started. Domestically little more because export had also started by that time.

Saket Kapoor: This ECU is mix for both chlorine and chlorine?

JK Jain: Yes. It is 1 ton of caustic and 0.88 ton of chlorine. Realization of both these products is ECU.

Saket Kapoor: And the chlorine market is still positive sir?

JK Jain: Negative now for last one or two.

Saket Kapoor: That could be the major contributor why the realizations have dipped sharply?

JK Jain: But even caustic has softened. So both the products have gone through softened stage.

Saket Kapoor: If you could explain in deeper sense, what factors were in the favor of chlorine when it was positive and now that it is turning negative and what is the likelihood in the near future?

Ajay Shriram: Saket, this is actually a matter of supply and demand. After all, we are talking of a commodity. Because the demand has come down a little bit from the user industry, that is why the prices become softer and international prices have also fallen, so that becomes softer and as I mentioned we expect this to be a little stable situation now. In commodities, little up and down, is part of the game. I think we are also as the management aware of that. Last couple of years we have had good prices which has been a benefit for the industry. And now our focus and attention is always based on how do we reduce our cost to become more efficient. We are putting up a captive power plant in Kota which will be commissioned in the next three months which will reduce our power cost. That will help us. Similarly, we are expanding in Bharuch. That is going to give us additional power which is going to be cheaper than the power we buy from the state government. So that will make us more competitive down the line in terms of our cost of production. So we are working and giving a lot of attention to these areas now.

Saket Kapoor: For us the raw material basket includes salt, energy, gas?

Ajay Shriram: Yes.

Saket Kapoor: And there has been a consistent decline in the coal prices also. So does that translate for the gas one also? How do things shape up for the raw material basket going forward?

Ajay Shriram: Coal prices have fallen internationally over the last six months which is a positive indication, but the end product prices have fallen a lot more.

Saket Kapoor: So there is a compression in the margin that is now evident?

Ajay Shriram: Correct.

Saket Kapoor: Sir, already the July is done with, the trend has remained more or less same or have we seen further decline in this ECU mix?

JK Jain: I do not think we will be able to share a specific number, but overall situation is being soft.

Saket Kapoor: For the user industry part, we have aluminum, paper being the major contributor in terms of the buyer. So which side has turned down – it is from the aluminum part or the paper industry that is consuming lesser quantity?

JK Jain: When you are saying aluminum, paper, etc., you are referring to cost savings?

Saket Kapoor: Yes.

JK Jain: Caustic is used in paper, aluminum, textiles, etc., Now what has happened is aluminum has started importing because earlier imports were not being permitted and the other segments have started .reporting downfall in consumption.

Saket Kapoor: Earlier, you said import was not feasible. Tariff was imposed, something like that because…?

JK Jain: Some non-tariff barrier in the form of BIS approval that government has stipulated, for the foreign companies. It took time in getting BIS approval and that is after the approval, import started from April, May this year.

Saket Kapoor: And sir for the downstream products, how much of our revenue in the chemicals segment will be attributable for this quarter and going forward, how much chlorine downstream products we are contemplating?

Ajay Shriram: I will just put in this way; we do not have any downstream products of our own right now, we have PVC, etc.

Saket Kapoor: We are not into Chloromethane, Hydrogen Peroxide in that basket?

Ajay Shriram: No, we are not.

Saket Kapoor: Going forward we should be expecting plateauing out of the same and if the strength remains there would be further pressure on the margin?

Ajay Shriram: No one can predict the prices of commodity, but at the same time we feel that what is happening in the international market and what is here, that we should be in a stabilization phase now.

Saket Kapoor: What was the utilization level for the quarter?

JK Jain: Overall capacity utilization was about 88-89%.

Saket Kapoor: What was it for the March quarter?

JK Jain: It was roughly the same because we have added capacity actually from April onwards. So even with increased capacity we have been able to keep the overall capacity utilization.

Saket Kapoor: So the question of demand does not factor in? Demand is then robust when your utilization levels are same even?

JK Jain: Not only my capacity utilization, it is the overall industry capacity utilization which makes a difference. What we have just explained is two things – One is demand and supply. On the supply side, as we just said, imports have started in a little bigger way. Which has created pressure on domestic prices and domestic production has also picked up. So therefore, overall supply has gone up.

Moderator: Thank you. The next question is from the line of Pratik Tholiya from Elara Capital. Please go ahead.

Pratik Tholiya: Sir, just on the Fenesta actually, the good set of numbers that you have reported and if I see last five quarters consistently your quarterly revenue run rate has been around Rs.100-odd crore and this quarter your margins are also at around 15% versus 12% last year. So, what is really driving the margins in this business right now?

JK Jain: These are the businesses which are volume-sensitive, Pratik. As the volumes go up, the margins also continue to improve. So we expect with having growth the margins will remain at a higher level.

Vikram Shriram: Also, I think the mix of retail is increasing because of the softness in the whole developers and project market. So, good part of the growth is coming from retail segment which operates at a better margin.

Pratik Tholiya: So, what sort of margins are you expecting maybe four quarters down the line if we will maintain the sort of volume growth and your retail continues to contribute more than the project which I think should be because project as you rightly said is still not out of the woods? What sort of margins you are looking at say 4 quarters down the line?

JK Jain: It will broadly remain 15-17% because we would be spending on new products, etc., also to sustain the growth.

Pratik Tholiya: Also, you mentioned in Fenesta, you all are trying to increase the footprint and all those initiatives that you are taking to drive growth. So if you could just elaborate a little bit on how much is where all you are present, what sort of footprint you have and where do you want to take this forward?

JK Jain: We are at about 140-cities right now and we keep adding cities as we see opportunities. So when we say, we are increasing footprint, it means we are going into next level of cities which is a continuous exercise plus we are also looking at adding further products in the basket. So that is what we meant by saying that we will take the steps to increase the business.

Pratik Tholiya: So, this 140 cities, any target for next two years maybe you want to reach 200 cities or something of that sort?

JK Jain: Difficult to say what is the target? As I said when we see opportunities and there are various criteria to identify it. We keep penetrating deeper into the city.

Moderator: Thank you very much. That was the last question in queue. I would now like to hand the conference back to the management team for closing comments.

Ajay Shriram: Ladies and gentlemen, we thank you for your participation in our Q1 Financial Year '20 Earnings Conference Call. We are focused on to keep strengthening our competitiveness and achieving volume growth across our businesses. Simultaneously, we are taking initiatives to improve our earnings profile by developing multiple revenue streams through forward integration. We believe these efforts will deliver sustained growth and healthy performance going forward. We are also committed to maintain a healthy balance sheet. Thank you once again for joining our earnings conference call. Good bye.

Moderator: Thank you very much. On behalf of DCM Shriram Limited, that concludes this conference. Thank you for joining us, ladies and gentlemen. You may now disconnect your lines.