Rallis India Ltd

3QFY15 Earnings Conference Call

MANAGEMENT:

Mr. V. Shankar – Managing Director & CEO

Mr. K R Venkatadri – Chief Operating Officer

Mr. Ashish Mehta – Chief Financial Officer

Tata Securities Ltd

Mr. Nikhil Gholani – Head of Institutional Equity

Moderator Ladies and Gentlemen, Good Day and Welcome to the Rallis India Limited Q3 FY'15 Results Conference Call hosted by Tata Securities Limited. As a reminder all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Nikhil Gholani from Tata Securities. Thank you. Over to you sir.

11 November 2014

Nikhil Gholani Thank you Varuna. Very good afternoon. On behalf of Tata Securities would like to welcome all the participants to Q3 FY'15 Earnings call of Rallis India Limited. Today we have with us Mr. V. Shankar, Managing Director & CEO; Mr. K. R. Venkatadri – the Chief Operating Officer; and Mr. Ashish Mehta – the CFO on the call. I will request Mr. V. Shankar for a quick opening remarks and the highlights of the results post which we will open the floor for Q&A. Over to you sir.

V. Shankar Thank you very much Nikhil. A very good afternoon to all of you ladies and gentlemen and welcome to Rallis. As it is customary, I will make opening remarks on our performance and leave enough time for a Q&A session.

As we have all seen the numbers, for the quarter profit after tax is Rs. 25.5 crores consolidated versus Rs. 30.3 crores last year same quarter. Standalone Rs. 32.5 crores versus Rs. 35 crores same quarter last year. We were very happy to say that we have set a new milestone on gross sales which has crossed Rs. 1,500 crores for the year-to-date, recording a 6% growth. For the quarter, we have crossed Rs.400 crores. Profit after tax to date marginally up at Rs.136 crores.

So, let us reflect on the conditions around these numbers and performance. As you are all aware that following these very turbulent south-west monsoon, Kharif season was quite volatile in a sense and the result of that set of situation, the numbers are there now that the food grains output fallen by 7% and across crops, there has been a sharp fall. So, the erratic rain fall, dry spells, and reduced crop acreages; all have led to lower Kharif yields and lower production. This coupled with lower crop prices; crop prices for most of the crops softened, so that together they have led to lower incomes for the farmer arising out of Kharif as if we entered into Rabi. In addition to this lower farm income, there is also tight cash flow constraint in the market have also led by the shortage of Urea which is also drawing out lot of cash from the market. So, this is the fallout of the Kharif and the situation in the market place. So, as we go down into the Rabi, opening of Rabi; the crop acreage-to-date is actually down 5% and the monsoon has been deficient or the departure from normal is around 33%. So, water deficit and commodity prices have impacted the post rainy sowing across the country.

Barring wheat in a few geographies, area under Maize, Oil Seeds, and Pulses particularly got affected. Area under these crops have dropped by over 15%. In Bihar, the lower commodity price of Maize influence sowing and there has been a crop shift out of Maize largely into Wheat, so which has affected the Corn which is a very important market for this season. Similarly in Andhra Pradesh, if you look at Telengana in particular, there has been a very sharp drop in the paddy acreage, even up to 30%. As a result of the lower acreage, these set of conditions, demand has been muted along with the inventory which is already there in the pipeline and therefore, as you know our way of working is to align our sales and placements to consumption. So, all this has resulted in volumes being a bit mute on the domestic side and we have made sure that our focus on cash and collections is relentless and it continues.

Alongside, we also note that the international crop prices have also fallen and in a way some of these crops which are affected by international crop prices; the cotton, corn or soya in India also. So, that reflection is there. In the international market demand, if you take a big country like Brazil which in fact is the #1 country for agrochemicals in the world, Brazil has also been facing challenges. There had been delayed rains and as a result their acreages have come under pressure whether it is corn or cotton and soya bean; why the acreage came up, a very-very low incidence of Asian rust which is a large draw for some of the molecules which go into the Brazil market. So, Brazil is a very-very big market with supplies from China and India and in fact, one of our key molecules, Acephate around this time Brazil is a big market. So, a very odd combination that during this quarter in Q3, conditions in domestic and conditions in some of the big international markets both have had headwinds.

Given all this, I must say we are delighted that the new products we have introduced Hunk, ORIGIN, and some other products which we are done in the plant growth nutrient space including our GeoGreen is steadily picking pace and has got a very encouraging response from the farmers. One only hope that we would have got a better chance to demonstrate the potential of these products and I am sure we will get it going forward particularly into the coming season.

In Seeds also, we have introduced a very nice and a very-very high potential Corn hybrid for the Bihar Maize market. But unfortunately, this season, there is we have seen this crop shift and even in hybrid Paddy, we have introduced two new bold hybrids which also have been received very well. These new seeds have not got a fair chance this season and some of our Corn sales have had to happen in markets which are not of as high value.

Metallic sales for the quarter has been at Rs. 35 crores which is up almost 50% compared to last year. Now taking a look at the margins' part of it, while this is on the sales' side, on the margins' side, I would say that the story is we have focused and actually improved on the quality of our margins and in the Domestic Formulation space, we have taken selective price increases on some of our key brands while it is not across the board, we have been able to do it on some of our important brands. The other thing which is also contributed to margins while it is still flowing through because of the lead time, it the impact of the softer commodity prices, the impact of the lower crude price and so on which touches some of our raw materials and procurement. So, that is also some of it flows through and we do hope that in the quarters to come, we will see more of that coming through.

On the cumulative, you see that the profit numbers have dipped a little further because of the Q3 loss from Metahelix; while on the revenue side there has been very healthy increase. Q3 typically is the loss quarter for Metahelix but as a result of the mix, the geography, and the product mix which we could do in this season; that has led to the loss in Metahelix about Rs. 4 crores higher than that of last year. I think what is more important at this stage is to recognize that we have not relented on whether Rallis or Metahelix to invest in our market promotions, farmer relationship, and brand building programs, and also research and development programs which is what is helping us to really bring in these powerful solutions every season.

The other items which also in some ways reflect into the operating numbers is couple of charges which we had to take during the quarter. One is the charges we paid as required per rules for the Dahej additional land which we have. In addition, we also provided for an amount for stock related judgments to record its fair value and all in all, if we take this and the focus we have had on working capital and cash, I would say that it was important for us to make sure that the quality of operations are upheld and in fact, the whatever improvement we could do, we have built that in. So, if we look at the cumulative margins which we have till date, they show a healthy improvement.

Going forward, we do have new products lined up in our pipeline both on the Seed side as well as Crop Protection and we are looking forward to the coming seasons actually taking benefit of all the new offerings which we have. Our "Rallis Kisan Kutumba" program, our pulses program as well as "Samrudh Krishi" and other relationship programs we have continue unabated and we continue to build and make them robust.

I want to close by having a quick word on the contract manufacturing side. I am happy that some of the work we have been doing with new customers is beginning to bear fruit. During the Q4, we hope to get regulatory clearance for one of the commercial orders which we want to execute. This is a pilot order but it requires that regulatory approval which we hope we will be able to execute in the Q4 and it is a very humble small beginning and in a couple of other relationships we are at the advance stage of moving it to pilot run and I am confident that over the next 12 months or so, some of these relationships is going to start turning into to formal commercial relationship.

Thank you very much for bearing with me on these opening remarks. I will now throw it open for question-answers, so that we could take any of your points you make in some more detail. Thank you very much.

Moderator Thank you very much sir. Ladies and Gentlemen, we will now begin the question-and-answer session. We have first question from the line of Balwinder Singh of B&K Securities. Please go ahead.

Balwinder Singh Firstly, on this top line growth that top line degrowth that we have seen in the domestic market. So, I would want to know how have exports done if you can throw some numbers say 5%, 10% growth or whatever on the exports side.

V. Shankar As I said, on the exports side, typically, this quarter does have some orders from countries like Brazil for our key molecules like Acephate. Now, because of the current their own season demand pressure and inventory, some of those orders have got muted. Fortunately, since we have got a slightly larger basket, we have also had orders on our other molecules from some other geographies. So, overall international business also have come up to similar level which we had planned for. Of course, I must quickly add that both on domestic and international, we had hope that it would have been higher, so, we did not really plan for revenue or a number anywhere lower than last year. We did plan for a growth but that was not to happen because of all the headwinds which I explained and therefore, within the opportunities we have been selective in making sure that the right product mix, we are going into the right markets with the right quality of operations, so that we do not compromise not only on the opportunity but on the profile opportunity which we do. Now, the exact combination and the exact number of the proportion of international business, I will share with that once we are done with Q4 and we will declare that number for the year as a whole.

Balwinder Singh I just I wanted to understand, have we seen like some 10%, 15% decline in domestic volumes as such, because overall when your top line has degrown by 6% and you say that you have taken price increases on key brand and also the fact that on a Y-o-Y basis, prices are higher that means domestic volumes have been down by 10%, 15% or so. Is my reading correct?

V. Shankar No, that could be one interpretation, but that is not the right interpretation because I did not say that we have taken price increases across the board in every single product in domestic. What I said was selectively we have taken prices. There are also brands where we have dropped prices because of intense competition, because of price corrections which were necessary. So, there also has been price reductions in some of our brands and where we thought that it is important to do that correction to make sure that our market presence is not lost. So, it is a combination of both. So, since we have large portfolio of products Balwinder, there are products on which we have gained volumes and gained handsomely. There are some products where we have lost volumes. There are some products we have taken prices up; there are some products we have even dropped prices even up to 10%. So, it is actually a combination of all of that. So, it is not correct to say that there is a volume dip of 15%.

Balwinder Singh On this margin side if I see, gross margins have improved substantially by 600, 700 bps this quarter. So, how much of that is sustainable going forward and does it like because of the crude price decline given the fact that we might not have adjusted selling prices lower still, so, are we going to take some price cuts going forward because of the crude price decline? So, overall I just wanted to understand, how much of the gross margins improvement is sustainable going forward?

V. Shankar See, Balwinder, I will read out the data which is in front of me and which calculations show. If we take Rallis number, I suppose you are referring to Rallis standalone; our EBITDA to date had gone up 70 or 80 basis points. So, I am not sure I am not able to connect with your 600 basis points.

Balwinder Singh No sir, I am talking only about Q3.

V. Shankar I am talking about cumulative to date. So, if you take overall, our performance so far on the Rallis standalone, our EDITDA, let say it has gone up by a 1% or so. So, that is I am saying in the light of all these conditions, it is our focus on making sure that the quality is not compromised and in fact we have improved on the quality of performance and that is a reflection of all the actions we have taken on cost reductions, on price increases as well.

Balwinder Singh No sir, just to keep it simple, I meant the 3Q performance. We have seen substantial growth margin improvement. Is that the 3Q margin can be replicated going forward or how does it look like?

V. Shankar No, the Q3 number, if you look at the EBITDA margin, they are at the same level as last year.

Balwinder Singh Gross margin.

V. Shankar I do not know whether, you will have to net off at the after all the expenditure. I do not which line you are taken and how you computed.

Balwindar Singh Sales minus the manufacturing is...

V. Shankar All I am saying Balwinder is to take all the expenses and if EBITDA is reflective good enough number, the number is not showing the kind of increase which you are talking about.

Balwinder Singh What you are talking of is EBITDA margin improvement of 100 bps right? So, on the EBITDA margin improvement, can we see sustained margin improvement over the next couple of quarters or has the crude benefit all come this quarter.

V. Shankar No, as I said, crude benefit, the lead time is there. So, maybe it takes a little bit of time for the crude to get reflected on to raw material and then from the raw material purchase, once the inventory which we have purchased, the draw down, so, it will get spread out over a period of time. Does not happen immediately.

Moderator Thank you. We move on to the next question that is from the line of Bhavin Shah from JC Investments. Please go ahead.

Bhavin Shah Just wanted to have some clarity on the CRAMS business. What kind of capacity utilization would we see next year with the order that you see regulatory clearance coming in?

V. Shankar I have kind of explained this before in the manner that for new businesses, we are adding facilities and we are doing as and when and the type of chemistry and reaction it requires. So, it is not as if you know I have a capacity of let us say, 100 and this order has come for 10 and therefore, my utilization is 10%. So, what we are doing is because each product and each chemistry and each customer could come up with, that is why it is quite longish, it is a 6 or a 7 stage building of relationships and it is quite a longish process of finally culminating into a contract manufacturer and it also, the commercial order starts in crumbs and once it really stabilizes and suddenly, it picks up into big numbers. So, the one which I mentioned to you is about totally new products, totally new chemistry, and we had to demonstrate that we have the capability to crack this chemistry to be able to do this product not only under lab conditions, pilot conditions, bring out the stringent specifications it requires and take it to a commercial scale. So, and the trail order which we got is the one we are hoping that the clearance will come and we will complete in Q4 and give. While in terms of capacity utilization and numbers, it may parse not be a big number to share. What it demonstrates for us and what it helps me convey is a good news is that we are cementing a new customer relationship. So, this is a and since they are all international and global customers who got many-many products and many molecules, many intermediates, once the capability and relationship is established, then the flow starts actually coming. So, it is difficult for me to give a number just now. But I think it is a significant piece of information enough for me to share that this is about getting one adding a new customer of an international scale.

Bhavin Shah On the new product launches would you dwell a little bit more in terms are they tie-up based products or do you have something innovative coming out. What sort of product visibility in terms of pipeline we see monetizing going forward?

V. Shankar This year itself we have introduced not tie-up products, they are from our own research centre and they are two big brands we are backing and doing lot of field work. One is a product which goes by the brand name 'Origin' and this is first of its kind which is a combination of an insecticide and a fungicide and this is been done by us. It is Rallis's own product.

Bhavin Shah Referring to the new molecule that would get launched?

V. Shankar For next year? We got a very good pipeline in fact over the last weekend only I was with our research team. They were showing me a number of products which we have ready. Now, it all depends on the regulatory clearance for us. We need to get the regulatory approvals and depending on how, in what sequence they come, that will, our introductions will depend on that. So, at this point in time beyond this, going into specifics, I will not be able to. But I just want to share the good news that we are ready to launch quite a few good new solutions.

Bhavin Shah When you say sir new solutions, what they mean? It would be Section 931s ones, tie-up ones, something that is completely differentiated, would that refer to that or would it be maybe a little modified ones in the existing market?

V. Shankar These are new solutions in the sense that they are not ones which are already there in the market. They are may not be totally new molecules also but they may be different ways of combining existing molecules and they are original our registrations. They are not the 94 me-too registrations.

Bhavin Shah Will be suffice to say that you have been waiting for these launches to come forth and probably the age of registration is moved up close towards launch and we could not see any deferral there.

V. Shankar Yes, we should, the sooner we get registration, and we will be. So, Kharif onwards, we will planning for the launch.

Moderator Thank you. We have next question from the line of Prashant Kanuru from Karvy Stock Broking. Please go ahead.

Prashant Kanuru Just wanted to understand in terms of crops in the Indian market importance of say, Pulses and Oil Seeds versus Wheat; now, which of these drives the volume pesticide percentage more? Would it be fair to say that Oil Seeds and Grams, i.e., Pulses drive it or as compared to Wheat.

V. Shankar Prashanth, Wheat, the large portion of the Wheat requirement is in the form of herbicides and while it has been an excellent Wheat season, consciously, we do not play big in Wheat herbicides because the two big molecules which go into wheat which is Clodinafop and Sulfosulfuron; they have become very low value products. It is very-very generic commodity and there is very-very little hedge left there. So, and depending on how the weather conditions prevail, if you taken a big call on sulfo and the markets swings towards clodino, in the past we have burnt our fingers we are sitting on inventory of sulfo because the fog happened a little more or little less or ahead of or beginning of season or middle of season. So, it is a bit of a thing and all this is worth taking when the margins are big enough for you to take that risk. So, consciously, we do keep our presence but we do not play very big in Wheat. We are big in Pulses and Pulses is good and we also have very-very good solution on pulses and new molecule on Pulses also and we work very closely with the Pulses farmer on our more Pulses. So, Pulses is an area of great interest for us, so our select Oil Seeds. So, for us I would say in general wheat wouldn't get priority over this but for us certainly, it is not wheat.

Bhavin Shah Sir, in pulses and oil seeds, it will be insecticides, fungicides, and herbicides; which of these segments would be more?

V. Shankar Pulses, the insecticides are more.

Bhavin Shah Coming to your CRAMS, you talked about a new relationship forming over there. It will be in pesticide technical and intermediates or just pesticide technical, what is it right if it is pesticide technical or just technical?

V. Shankar No, as far as contract manufacturing is concerned, we are actually leaving the field open to chemistry. We have expertise in chemistry. So they could go into different applications. Actually, the one I refer to is the one trial order we are doing this quarter, but there was one we did in the last quarter which is into Polymers that is a totally different application. We have done one before that which happened I think in the second quarter. We have actually done three or four trial orders already. That one went into Animal Application -- Animal Hygiene. So we are open to even intermediates which can go into pharmaceutical application.

Bhavin Shah: That is a very broad…?

V. Shankar: Yes, broad because here we are offering our expertise in chemistry, our expertise in managing projects, our expertise in manufacturing, our expertise in able to be a reliable supplier and also to build a trustworthy relationship. So, we are not limiting ourselves to Agrochemicals; of course, Agrochemicals is our forte and anything comes that way we are most delighted as well.

Bhavin Shah: Metahelix what is the loss for the first nine months cumulative levels?

V. Shankar: Metahelix I would rather urge you to look at; one is the top line which is the market space we are building, because it is relatively a new space for us, it is not as mature as crop protection for us in Rallis. And secondly, Metahelix, I would also urge you to look at a cumulative number for the year. Because when you look at the Seeds business, it begin with the Q1, where a lot of action happens and the rest of the quarters actually we manage the whole season. So, what happens in other quarters is there are two big expenditure which we have – one is it is not enough if we sell the seed. We have to nurture a seed all through its life till it is harvested and we have to continue the farmer relationship at every stage of the crop, the Seed business is very involved and very intensive that way. So, whether it is Q2 or Q3 or Q4, we continue to engage with farmers and therefore there is a lot of field level activity. We also have to keep demonstrating how good our seed is, how good the crop is, and we have all these farmer activities, crop seminars and so on. Second thing which we do not relent and we keep investing and working all through the year is in 'Research and Development.' So, breeding program or field trial, the various research activities, we continue to spend. But, accounting requires that having taken all the revenue in the first quarter accounting standards do not allow you to book all expense in the first quarter and it is proportionately only whatever I am able to sell in the other quarters I will take the expenses. Since it does not happen that way, structurally therefore the other quarters run into losses. I am also not saying that this can never be avoided is you have to be very good at everything. So not only you are good in mathematics, you have to be good in Sanskrit, you have to be good in geography, everything. So, if it is a quarter where vegetables are sold, you have to have vegetables; if it is a quarter where Cumin is sold you have to have in Cumin; Wheat is sold, but we are not in every crop and for that matter I must say we are not even into Cotton in a big way which accounts for as much as 50-55% of the market. So if Metahelix has already ramped up sales, which is touching almost a healthy Rs.250-300 crores and being counted among the top 7-8 companies in Seeds, it is without Cotton largely and some of the big Seed companies who rank 1,2,3,4, etc., are really Cotton-driven. So, we are getting our act together on Cotton, in fact, we have just introduced some Cotton this year, which I have got very good response. Imagine when we ramp up Cotton, and that is what we want to do and we will do. So the answer to the quarter wise thing is how do I also be present across all things which happened in different quarters and also how am I present in different geographies. For example I told you in Rabi Bihar Maize is a big market and this is the first season where we introduced a new Bihar type Maize which is high value, high input-oriented but sadly for us the Bihar farmers decided to go out of Maize and do wheat so it did not get a fair chance. So we are in the process of building portfolios like this which will give us a presence in other quarter. Second is to go outside India and market seeds in countries which have robust Q3, Q4, etc., which also is should happen over a period of time for us. So this is just to explain the structure of the business.

Prashant Kanuru: Sir, just a last thing. Between cotton, corn and soya; corn and soya relatively more stable in case of pricing as of now but cotton has seen a big beating in the international market. So do you see corn acreage going up or soya acreage going up versus cotton next year?

V. Shankar: Farmers at the end of the day go by farm economics. At the beginning of the season this year also we said that cotton is going to be down, etc., it ended up doing a record 12 million hectares. So not to worry India has become a leading player in cotton. We are doing almost 400 now in terms of cotton production. We have become very big in the world. These ups and downs will be there. Sometimes China cotton may drop; US may drop; India cotton prices will go up and sometimes it may go a little down but cotton is very big. Cotton has become remunerative and I do not see cotton acreage falling drastically.

Moderator: Thank you. We move on to the next question that is from the line of Viraj Mehta from Value Capital. Please go ahead.

Viraj Mehta: I just had a couple of questions. One was on Metahelix. If you can give us on 9 months to 9 months compared to last year what has been the kind of growth?

V. Shankar: If we take the sales for the nine months I think there is almost a growth of 40% in these nine months over last year and last year itself had grown handsomely over the previous year. So we are recording as I said in a matter of may be 3 to 4 years we are beginning to touch Rs. 300 crores which for the seed industry is quite an accelerating performance. And on the bottom-line as I said we continue to invest so the bottom-line growth is more of the order of 20% and this is a conscious decision by us that we need to invest more into farmers, brand promotion and market development activities as well as into the research and development programs and therefore and this is a conscious investment which we will be making.

Viraj Mehta: Sir, as I understand and if we recollect our discussions a year back you had mentioned incremental EBITDA above a certain level of sales is much, much higher. So if you had to put in one figure beyond which incremental contribution would start going directly to the EBITDA level. What would that number be in terms of sales for Metahelix?

V. Shankar: No Viraj, what we are doing is our EBITDA is steadily going up because our sales have gone up; our level of contributions have gone up; EBITDA is going up. What we are also doing is as we are able to generate more and from a loss not very long ago. Now we have a positive healthy bottom-line. We are also increasing our research spends. So we would really like to in Metahelix have the level of research percentage to revenue at a very healthy level and this is going to be a knowledge led a science lead business and we are as we can we are improving our facilities, we are deploying more resources, and we are also adding on more crops on which we will do research on.

Viraj Mehta: Any update on cotton that if I remember correctly in our conversation you had said that we had applied for our own BT genes. Is there any update on that and we are basically not buying it from Monsanto the gene?

V. Shankar: No, that is not true. We had invented our own gene now that gene is unique to us. But that is the level one gene. The current bollguard equivalent products in the market are two stag genes. Ours was not two stag we are working on further but the thing is that field trials and new biotech approvals are not coming through. So right now most of the licensees are of the same Monsanto technologies. What I said we have introduced this season is the hybrids. So I did not mean sorry, if it was understood as technology.

Viraj Mehta: I understand your part. I was talking about like an analyst meet a year and a half back probably.

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

Nitin Gosar: I just wanted to understand the market scenario. One is on the working capital and two is on the farm economics where the end product prices have come down far below the MSP or are they very close to MSP?

V. Shankar: On working capital situation is very difficult; extremely difficult. I am not particularly talking about Rallis because as you know this is our prime focus area. We really do not extend ourselves so much that we compromise on the quality just to buy some additional top-line. We generally do not want to do that so we have a sharp eye on cash and the debtors and so on and the average collection period but that is not the general condition in the market place because our understanding is credits are very long, the debts are in huge numbers, and therefore it is difficult situation overall working capital. As I said earlier what has accentuated the problem is the severe cash constraint because urea is sucking up all the cash in the market. Urea is in short supply and all the cash is chasing urea and that is a very big industry and crop protection is a small industry. So if that big industry sucks cash there is very little available. So we are very, very conscious about this and therefore we are balancing both the sales and the quality of sales and attempting our best not to lose market presence and therefore doing the right type of sale so that it just does not go and sit somewhere and does not improve our market presence in that sense. So we are working close to consumption as much as possible. So that is what I would say on working capital.

Nitin Gosar: And the other question was pertaining to the end product prices with regard to the food grain prices. Are they very close to MSP, have they corrected far below MSP?

V. Shankar: Firstly, MSP is an excellent reference point because it is known to everybody that this is the intended price or this is the minimum price at which a farmer should get but the sad thing is that there is no formal structure all over the country whereby farmers can go and get that minimum price. It operates very, very selectively particularly in some northern states in some crops and unfortunately while last few years for most crops the actual market prices have been above MSP sometimes far above MSP. I think now we are seeing in some crops actually going below MSP. So there are pockets and there are geographies where people are realizing paddy prices below paddy MSP. So in today's context it is different where there are geographies where people are not even realizing the MSP.

Nitin Gosar: So the scenario in terms of farmer's economics is far, far worse than what could have been three months back? We are only struggling three months back with the erratic monsoon now the commodity prices also which have come off?

V. Shankar: Yes, so if you take cotton few months back which was hovering around Rs. 6,000 come down to Rs. 4,000.

Nitin Gosar: And sir, my final question was pertaining to some clarification on gross margin which earlier participant was asking. Revenue minus the raw material so that number as a percentage has gone far above what you otherwise generally report and this is almost matching up with what happened in FY10 that is when the commodity prices also corrected. So during this quarter did we see any kind of commodity or the input price related benefit?

V. Shankar: No, we have seen some dip, there has not been a significant cost dip that way which is driven by our commodity prices or anything. We think over a period of time because now we are seeing some of the raw materials beginning to reflect drop in prices. Now those raw materials now we have to buy. First we have the exhaust whatever we have in stock so it will take some time. So a direct answer to your question is the Q3 numbers do not really reflect any big fall in the raw material prices into our numbers. At least we do not have that.

Nitin Gosar: So it would be right to assume that despite some or probably there are no benefits which is available from outside it is all about the sales mix that has improved may be on YTD basis or even on the third quarter basis because of which your gross margins are looking better?

V. Shankar: Yes, but I am a little confused actually. You have to take all the thing including the other expenses and you have to compute the margin. So if you take only one line item and take revenues then it may not reflect.

Nitin Gosar: Probably we will have to wait for the annual report?

V. Shankar: Yes, please take all the elements of expense and thanks for giving me so much credit. I also do not want to leave all the credits. We have improved our margins, it is not that we have not improved. So certainly we have improved and we have worked hard for it but I do not think there is an improvement of 600 basis points.

Moderator: Thank you. The next question is from the line of Abhijeet Akela from IIFL. Please go ahead.

Abhijeet Akela: First, just to understand the one off item. So if you could just talk a little bit about what those who have this; Dahej land charge and secondly the stock related adjustment what exactly was it related to?

V. Shankar: The first one is related to the Dahej additional land which we have. So we initially bought a plot of land on which our current factory is located. Then we were lucky this happened a few years back the land adjacent just back adjacent to us was also available which we bought because we have plans to expand and invest and grow and the contract manufacturing business, etc. So which we bought a few years back so that is also in our position. Now to consolidate and extend that there are as per the regulatory authorities there are some charges which have been paid. So we have got the approval and we had to pay those charges and since they are almost Rs. 2 crores which happens to come in to this quarter we thought that we should just share that information.

So that is on the Dahej land. On stocks-related adjustments this is as you know in any manufacturing setup across the business we carry plenty of inventory which is spread across raw materials, in-process, finished goods everything and from time-to-time we have to recognize the entire stock in terms of its quantity, quality, valuation, and so on. So as a result of this and looking at the usability of the stocks into the third quarter it came to our recognition that we needed to make this adjustment of Rs. 5.4 crores to record the fair value which we have taken it into the third quarter. Again given this amount we thought that it is good to highlight this separately so that it is known that this figure is built in to the quarter numbers.

Abhijeet Akela: And just to clarify both these items are being shown under other expenses; is it?

V. Shankar: The raw material thing that goes into this material consumption.

Abhijeet Akela: And secondly just on the revenue breakdown just to clarify exports can we assume that actually there was some YoY growth this quarter or would there are any decline?

V. Shankar: Exports as I said earlier we have had one of our big markets some orders which we would have normally got because of the market conditions there but we could access other markets. So exports have been while it has come closer to our intended number we could have done even better. So I will have the exact number at the end of the year.

Abhijeet Akela: And one last clarification. Given this correction in crop prices if we assume that crop prices stay at this level until next Kharif season what would your sense be about how sentiment might be next season, can it continue to be subdued or do you think if the monsoon is better things will be better what is your assessment?

V. Shankar: Heavy commodity crop prices are directly influenced by demand supply like any basic economic thing. So it is a little less complex than I think predicting FOREX movements and other things which people try to... And therefore it is possible that the prices can start firming up. They are also linked to what happens in international movements and because it is an agriculture production related which is controlled by nature so to speak a season failure here or a bumper there can have in one season a big influence on the price. For example certain pulses which not long ago were seen as prices having tumbled and fallen you can see Red Gram prices are quite high now. It is very, very difficult to say or even conclude that it has gone down so it will remain down. It can change even in a season.

Moderator: Thank you. The next question is from the line of Kuldeep Khanapurkar from Kotak Asset Management. Please go ahead.

Kuldeep Khanapurkar: Just one or two questions. On the raw material earlier remark you said the prices have gone down and the full impact has not been noticed in third quarter. Now I just wanted to understand how much has been the correction in the raw material prices and second question would be in the wake of slightly weaker demand environment would the industry and Rallis in particular be able to hold on to the prices or they would most likely pass on to the farmers?

V. Shankar: Kuldeep, let me make a confession. I did not know that there will be much of interest amongst all of you on exactly this crude and the linkage and I do not have a ready number. So if you will pardon me I cannot give a ready number on what is the impact. What I know for sure is that it has not been so significant that the Q3 numbers have been very favorably kind of affected by this price drop. So that much I can tell you but exactly how much has come in; what will happen in Q4 I do not have a ready thing. So but that since so many of you have asked that question I think my team and I will just look into that and see what impact it makes.

Kuldeep Khanapurkar: Now before second actually the reason probably everyone is asking is also if you adjust for the inventory hit that you have taken that is one time charge that you said. The expansion in your gross margin is almost to the extent of 700 bps and that is the reason probably everybody is wanting to understand this part. But anyway I think maybe you have not quantified it in that way. So on the second part was really given the poor volume growth would there be a price correction going into the next season or you do not think that is the case?

V. Shankar: Yes, let me make a few comments on your first one. As I said earlier just do not take the raw material you must take the other expenses everything together to assess the gross margin or better still you look at the EBITDA number. Because the reason I am saying Kuldeep is that see in our portfolio, in a way that is a blessing that we have a mix of two or three ways of providing solutions. One is we have our own research; we buy raw materials; we do the entire backend manufacture; we do the technical; we formulate. So that has one kind of costing. The second one is we have strategic alliances where I would get the active ingredient then I buy other materials then I formulate then I bill my own brand. Then there is a third segment which is sometimes I actually do co-marketing of select products with certain partners where I do not have to go through all these process. So depending on a particular quarter and the type of products I am selling depending on which basket that comes from your mix could be different. So it may not actually be enough for you to take one line item. Because my mix may change from quarter-to-quarter or it appears not only in one line item it appears across line items. So unless you take all of them and look at it together saying that what is my total cost of goods sold it may not reflect the margin in its entirety. So that is the way I would encourage all of you to look at it. Certainly if you add back these two items and I think conceptually that is not a wrong thing to say that they do not entirely pertain to this quarter so why do not I add back to get the real underlying performance of the quarter I would not argue with you I would say that Yes, that is not a wrong approach please do that. But what I am saying is while you do that and I endorse your approach please also take all the expenses do not take one or two line items.

Kuldeep Khanapurkar: No fair point. I think even if you add that the operating EBITDA level there is a 250 basis point of improvement?

V. Shankar: Yes, that is correct. If you add that I said 100 if you add that it becomes 250 that is fine.

Kuldeep Khanapurkar: So the next obvious question is whether you will be able to maintain that kind of improvements into the coming quarters given the demand-supply situation at the market?

V. Shankar: See it all depends as I said one component of that is also the product mix. So depending on what is in demand and my preference is always to sell my branded my own proprietary value added products. That is my first call. So if you look at like the products I have like my Takumi, my Ergon they are all premium products. My first preference is there. They are actually grown. So some of these products I have been able to effect price increase because this is where most of my investment go in building farmer relationship and establishing brand. Equally they have been some brands where they may be also a big contributors in revenue, etc., where because of huge competitive pressures some inventory pressures not my inventory but pipeline inventory in the market place I had to take price calls. So going forward when you say will you be able to maintain prices I only want to say is that it is not that I have increased prices across the board now question of maintaining it have also taken calls on price reductions. So the same approach will happen we will evaluate every opportunity and whatever is appropriate we will do. So the intent of course let me say clearly that the intent is to maintain the quality of the operations. But depending on the final mix I make so it may be 50 basis points here plus or minus but the intent is to maintain and attempt to improve the quality of operations and the margin.

Kuldeep Khanapurkar: And also have you seen the mix volatile across seasons or you think once you achieve a certain kind of mix you can only improve from there or you think it is volatile across seasons?

V. Shankar: Now it depends on the pest attacks. You have heard about the brown plant hopper, right that is a very dreaded pest on paddy on which we have an excellent solutions.

Now if there is a severe attack in a particular season my marketing response would be slightly different from a season where there is no attack and we are well-prepared with that, etc., and we are encouraging farmers only to prophylactic spray. I cannot have very aggressive positions in that context. So actually it is difficult to say that one season this happened and therefore this is the stable one and I only build on here from here onwards like that. Soya herbicide a runaway aggressive market last few years this year it has been a disaster completely. In fact thankfully we do not have big positions there but it has been a very, very different situation on what marketing you would do in previous years and what you could have done this year.

Moderator: Thank you. The next question is from the line of Pulkit Agarwal from Karma Capital. Please go ahead.

Pulkit Agarwal: Just wanted to ask you for the next two to three years if we look at Rallis India's business which products or business or geographies do you see driving revenues in margins? And also if you provide any guidance?

V. Shankar: See let me try and answer your question at a slightly higher plain. Seeds as a category and as an agri input category and a business is quite robust and growing at anywhere between 10% and 15%. And most of the crops they are growing barring some core serials like Jowar and all that which is steady to decline. So it is a good category. As long as you are having value creating solutions there you have a good set of solutions and you have good relationship program and capable work happening at the field. Equally in crop protection there is a need for crop protection and more and more emphasize is on sustainable solutions, paper solutions and higher value solutions which can also generate higher value and give you good quality and output. So in value added segments for example can I even export those. So there is a good requirement and need for both. So given some kind of a baseline I would say that in both these categories progressive businesses looking at value-creating solutions it is actually very, very exciting opportunity and farmers will prefer good value-creating solution and not so much weaker on unit prices. In the crop protection category let me also add that category like herbicides which used to be very small not very long ago is increasing at a very, very fast pace poorly because it brings in a label saving device it helps in cutting down costs and agony for the farmers in finding adequate labor to do the farming. There is also a lot of requirement of fungicides particularly on fruits and vegetables and fruits and vegetables has been a growing category in India and value-added foods a vegetables are increasing in a very handsome way.

So these are all good opportunities unfolding there is room for good technology, there is room for value added solutions. So I do see that all these categories have very, very robust future. We also are seeing a good acceptance and a good acknowledgment of paper solutions and greener solutions. So in our own portfolio in the last three to four years we have been steadily and consciously increasing greener products. We have also introduced organic products particularly in PGN and the GOB in soil conditioner they are fully organic they are green products and we can see lot of traction also in this category.

Last but not the least and we have discussed today also extensively is on manufacturing and if anything this Make in India campaign and the focus of the government only augurs well for this I think India is more and more becoming a preferred destination for manufacturing and our own foray and focus into this area. While I know it is testing all our patience and more than your patience it is testing my patience which is taking its own time in building the business but I know for sure that this is a healthy category to be into and it has a great future. So these are some of the things which I will say and share which are part of our strategy anyway.

Pulkit Agarwal: Sir, is there any revenue CAGR target that you would be happy with in achieving over the next five years and any profit margin numbers that you look to achieve that you would be comfortable with?

V. Shankar: No, if you are asking forward looking number I do not do that. So I think I have described enough on what is on our agenda and I will leave it to your own interpretation please.

Moderator: Thank you. We have the next question from the line of Satish Mishra from HDFC Securities. Please go ahead.

Satish Mishra: Sir, just last one question. What would be the CAPEX going forward considering the pickup you are seeing in custom synthesis business?

V. Shankar: We have not planned for any major project in CAPEX so we would be doing in our normal range of anything between Rs. 50 crores and Rs. 100 crores and right now all our CAPEX is really focused on getting all our current projects up to speed; current opportunities up to speed. So we have not quite thought about investing big in to a new project just now.

Satish Mishra: And sir, just in custom synthesis you have highlighted that we went through trials of some of the products in Q1, Q2, and Q3 also so how has been the response?

V. Shankar: Trials of which one please?

Satish Mishra: You said we had trials of some products in Q2 and Q3 also which were related to polymers or animals related stuff?

V. Shankar: Yes, not only trials we have also dispatched some test orders already. So they are into commercialization stage. Now we have to wait for bigger orders of that.

Satish Mishra: But the regulatory hurdles are over for those products or still it is in that?

V. Shankar: Yes, they are over.

Moderator: Thank you. Ladies and gentlemen, due to time constraint that was the last question. I would now like to handover the floor back to Mr. Nikhil Gholani for his closing comments. Over to you, sir.

Nikhil Gholani: Thank you Karuna. We would like to thank all the participants for the time and do apologize for the constraint of time. Thank you Mr. Shankar, Mr. Venkatadri, and Mr. Ashish for the detail discussion. Thank you so much and have a wonderful day.

V. Shankar: Many thanks Nikhil and many thanks to all participants from all of us in Rallis.

Moderator: Thank you very much, sir. Ladies and gentlemen, on behalf of Tata Securities Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.