DCM Shriram Ltd.

Q2 FY18 Earnings Conference Call Transcript

November 13, 2017

Moderator: Ladies and gentlemen, good day and welcome to the DCM Shriram Limited Q2 & H1 FY'18 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 call, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now handover the conference to Mr. Siddharth Rangnekar from CDR India. Thank you and over to you, sir.

Siddharth Rangnekar: Good afternoon and thank you for joining us on DCM Shriram Ltd.'s Q2 & H1 FY18 earnings conference call. Today we have with us Mr. Ajay Shriram - Chairman and Senior Managing Director, Mr. Vikram Shriram – Vice-Chairman and 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. 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 in this conference call may be forward-looking in nature and a note to that effect was included in conference call invite sent to you earlier.

I would now like to invite Mr. Ajay Shriram to give us a brief overview on the Company's performance for the quarter and half year ended September 30th, 2017 and his views going forward. Over to you, Sir.

Ajay Shriram: Thank you. Good afternoon ladies and gentlemen, and a very warm welcome to DCM Shriram Ltd.'s Q2 and H1 FY18 earnings conference call. I will take this opportunity to share with you key developments in our businesses and outlook going forward, following which Vikram will take you through the financial highlights of the Company.

The Company has recorded a healthy performance in Q2 and H1 FY 2018. Chemicals business witnessed growth in volumes and margins, Sugar business reported higher volumes with stable margins. Other businesses also witnessed improved operating performance.

Expansion projects in Chemicals and Sugar Co-gen at an investment of Rs. 700 crore were completed last year in Q3, we are witnessing full year benefits in the current year.

With the objective of strengthening the businesses, primarily on downstream products, Company is implementing projects worth ~Rs. 350 crore in Sugar and Chemicals businesses.

(i) The Distillery in Sugar will come on-stream by January 2018 at an investment of ~RS. 190 crores.

(ii) The capacity expansion in Caustic Soda Liquid & Flakes and Stable bleaching powder at Kota at an investment of Rs. 98 crore and Ammonium Chloride Plant at Bharuch at an investment of ~Rs. 43 crore is expected to be commissioned by June 2018.

Now, with the objective of increasing capacities along with integration and cost efficiencies, the Board has approved additional investments worth ~Rs. 850 crore in Sugar and Chemicals Business along with Power utility.

(i) In Sugar business the proposed investment is Rs. 500 Crore. Sugar and Co-gen capacity expansion at an investment of Rs. 360 crore will be commissioned by Oct 2018. Distillery capacity expansion at an investment of Rs. 140 crore will be commissioned by Oct 2019.

(ii) In Chemicals business the proposed investment is Rs. 98 crore. The capacity increase at Bharuch will be commissioned by April 2019 and at Kota by September 2019.

(iii) In Power utility we are investing Rs. 240 crore to setup a new Power plant at Kota in part replacement of existing power plants, completion is expected by September 2019.

All these investments will add significant sustainability and growth to our performance.

Let me now take you through the business wise developments:

Chloro-Vinyl

Chemicals: Completion of the expansion and technology up-gradation project at Bharuch Chemical complex last year at an investment of ~Rs. 580 crores has led to significant volume growth for the business. The plant is now operating at ~ 90% capacity utilisation. Chlorine absorption in the market is improving; this would lead to further improvements in capacity utilization over the next few months. The domestic product prices are moving up in line with international prices, which continue to firm up. Input costs especially that of power which was witnessing an increasing trend over last year, has been stable over last few months. However with global energy prices rising we expect costs to move up. Our investments in technology and scale will help in maintaining reasonable margins.

The Capacity expansion project at Bharuch completed last year has taken up our total Chlor-alkali capacity from 780 TPD to 1345 TPD. The new expansions discussed above will add another 310 TPD of Caustic Soda capacity. Further the capacity for Caustic Soda flakes will go up from 350 TPD to 500 TPD and Stable bleaching powder from 48 TPD to 96 TPD. The new Aluminium Chloride plant has a capacity of 60 TPD. This augurs well for captive chlorine consumption.

The Chemicals is a growing industry. These investments will further increase our scale, integration and optimise our cost structures.

Plastics: The prices of PVC as well as Carbide are stable. Coal costs have stabalised sequentially however Carbon costs continue to rise, putting pressure on margins. We are reviewing steps to further enhance our cost competitiveness to protect our margins.

Chemicals and Plastics are Power intensive businesses. We have captive power plant at Kota as well as at Bharuch to support these businesses. With the objective of improving efficiency in power generation, we are now setting up a 66 MW power plant in replacement of old sets of 50 MW at Kota. The new plant will be ~22% more efficient than the existing sets. The additional power will meet the requirement arising from expansion of capacity at Kota.

Sugar

The Sugar capacity utilization at our plants reached about 85% in the season 16-17 from ~60% in the season 15-16. This year the crushing has started early and we expect to reach close to 100% capacity utilisation. With reasonable weather conditions and recovery, we should be able to achieve growth in production volumes in the current season. The overall domestic sugar production is expected to be in line with the demand hence we expect the domestic prices to be stable in the current year. On the cost front the SAP for the season is higher by Rs. 10 per quintal, however with higher production, we do not expect corresponding full increase in our cost of production per unit, over last year unless there is any change in sugar recovery. These factors will lead to stable margins. We expect the central and state governments to continue with the reasonable policy environment which is healthy for the farmer as well as the industry. The 150 KLD molasses based Distillery project, to produce ethanol at our Hariawan sugar unit, is progressing as per plan and is expected to be completed by December'17. This will further strengthen our sugar business.

Cane availability in our area is improving. Industry fundamentals have been positive over last few years. In view of this the Board has approved expansion at Hariawan unit. This involves Sugar Capacity addition of 5000 TCD, Co-gen by 34 MW and Distillery by 100 KLD. These investments will take our total Sugar capacity to 38000 TCD, Distillery to 250 KLD and Power to 145 MW and will make us highly integrated.

Bioseed

This is an offseason for India operations with low sales vs the first quarter which covers majority of Khariff Season. In Khariff 2017 season the total sales of BT cotton stood at 37 lac packet vs 32 lac packets in the last season, Corn and paddy had stable volumes. We expect the business to witness satisfactory growth going forward.

In International Operations, the performance across all territories has improved in the quarter. This has encouraged us and we are working towards improving performance further.

Shriram Farm Solutions

The Business has been witnessing challenging times over last couple of years led by adverse climatic conditions and regulatory changes in the operating environment. This resulted in demand for good quality Agri inputs remaining subdued. SSP volumes were stable. The growth in this business is expected to remain muted in the near term.

Fertiliser

The business operations are stable. The Company is working with the Govt. for a more rational policy particularly for fertilizer plants with coal based power, to ease the energy consumption norms. DBT has been implemented in some of the areas where we sell Urea. The mechanism is not working seamlessly, causing delays in Subsidy claims. The Subsidy outstanding position continues to be a matter of concern in absence of consistency in release of subsidy payments.

Fenesta

The business is witnessing continuous growth in revenue and earnings led by higher billing. However we are experiencing lower order bookings in our 'project' vertical, a result of slowdown in real estate industry. Retail segment bookings are growing at a slower pace. Fenesta is expanding its market reach, product portfolio and service delivery to sustain growth and leadership over medium term.

Cement

The cement sector has seen pick-up in demand over last two quarters, leading to improvement in prices. However of late, the prices have declines. We expect that with government's focus on infrastructure including housing, this sector should see positive movements in future.

We will continue to evaluate investment options that strengthen our business. With good cash generation and healthy balance sheet, we are confident of sustaining growth over medium term.

I would now request Vikram to take you through the financial highlights

Vikram Shriram: Thank you. Good afternoon ladies and gentlemen. I will now summarize the financial performance of the Company. The overall Q2'18 Net Revenues at Rs. 1605 crs. grew 17.5% over same period last year. The revenues of own products at Rs. 1394 crs. were up by 33% whereas revenues of traded products at Rs. 211 crs. were down by 34%. Growth in revenues of own products included 23% growth in volumes led mainly by Chemicals & Sugar. All other businesses also registered volume growth. The PBDIT for Q2'18 at Rs.306 crs. was up by 133%. The PBDIT for own products was Rs. 299.2 crs., up 121% over last year. The margin for own products went up from ~ 13% to 21%. Most of our businesses recorded improvement in margins during this period. The finance costs and depreciation charges were higher consequent to capitalisation of Chemical expansion projects in September 2016 and Power Co-gen in Nov. 2016. Tax rate was also higher, estimated at ~ 24% for the current year vis-à-vis 13% last year. The Net profit at Rs. 172 crs. is 88% higher than last year. The Gross Debt as at 30th September, 2017 was Rs. 673 crs. and net debt at Rs. Negative 44 crs. vs. Rs. 737 crs. and Rs. 707 crs. respectively, last year. The financials for H1'18 recorded similar trends as the Q2'18 financials. Overall net revenues was up 26.5% with revenues of own products going up by 42%. The own products recorded 33% volume growth, led by Sugar & Chemicals. The PBDIT at Rs. 648 crs. was up 70% and PAT at Rs. 405 crs. was up 57% over H1'17. Let me now take you through our business wise financials.

Chemicals:

Net revenues of this businesses for Q2'18 at Rs. 338 crs. grew 66% YoY and 15% sequentially. As you are aware we had fully completed the Chlor-alkali expansion cum technology up-gradation project in September'16. The project involved 72% capacity expansion and about 12% reduction in power consumption. The business has achieved overall capacity utilization of 93% in Q2'18. The prices of Chlor-Alkali firmed up during the quarter, up 9% over Q1'18 and 28% over last year. We may mention that in Q2 last year, the prices had dropped significantly.

The PBDIT of the business, at Rs. 163 crs. was up 171% YoY and 33% sequentially.

Plastics:

The Net Revenues of the business for Q2'18 was up by 17% due to higher volumes. PVC prices remained at last year's level, where as carbide prices were up by 6%. PBDIT went up to Rs. 34.5 crs. vis-à-vis Rs. 23 crs. last year due to higher volumes and a one time debit of Rs. 5 crs. last year.

Sugar:

Q2 Net Revenues of sugar business at Rs. 516 crs. were up 39% YoY. The Sugar sales volume were up 34%. The selling prices went up by 5% and mitigated most of the increase in cane cost. The Gross margins, therefore, remained same as last year. Molasses recorded sharp drop in prices in Q2'18, which adversely affected the profits of the business. The PBDIT of the business at Rs. 81.4 crs. was up 18.1% in Q2'18 vs. last year.

Inventory level as at 30.09.2017 was 3.9 lac qtls. (vs. 6.0 lac qtl. last year). Early start of crushing for sugar season 2017-18 will help in maintaining sales during Q3'18 inspite of lower stocks as on 30th September, 2017.

Fertiliser:

Net Revenues of fertiliser business in Q2'18 were up 13.1% YoY. The volumes were up 14% as we had 11 days plant shutdown in Q2'17.

The PBDIT for the quarter was Rs. 35.7 crs. vs. Rs. 7.9 crs. last year, due to higher volumes and accrual of Rs. 14 crs. during the quarter on account of revision in freight rates for 2008-09 to 2015-16.

Shriram Farm Solutions:

Q2 FY18 net revenue declined by 37 % to Rs. 152 crores. 'Value Added' segment's revenue stood lower by 24 % vis-à-vis last year. Sales of Crop care chemicals and Specialty fertilisers were lower over same period last year. The PBIT stood up at Rs. 7 crores vs loss of Rs. 3 crs last year. Earning improved due to better PBIT margins in value added inputs and because of a charge of Rs. 8.5 crs. last year on account of discounts on sale of DAP/MOP, a discontinued activity.

Bioseed:

As you know, Q2 is an off-seaon for this business in India with low sales. India Revenues in Q2 FY18 increased to Rs. 58 cr. vs. Rs. 44 cr. last year. PBIT loss for India business at Rs. 2 crore was lower vis-à-vis Rs. 3 crore last year.

International Business saw stable revenues at Rs. 22 cr. vs. Rs. 23 cr. last year. PBIT loss reduced to Rs. 0.5 crore from a loss of Rs. 5 crores last year. Earnings improved led by better margins, a result of lower input costs and lower returns.

Fenesta:

The Q2 FY18 net revenue was up 35% YoY due to higher volumes. 'Retail' revenue was up 14% and 'Projects revenue' was up 107% as the execution in both Retail & Project segment was satisfactory. . Business earnings improved as a result of higher revenues. The business is making positive PBT over last several quarters.

The bookings of the fresh orders, however, has seen some challenges. The Retail segment recorded 5% growth in order booking in H1'18 over last year. Projects recorded sharp drop in fresh bookings as the sector continues to face challenges.

Other Businesses:

Operations of Cement business were stable. The turnover of Hariyali Business went down as we surrendered 8 of the 37 fuel pumps back to BPCL. Overall, the performance in Q2'18 and H1'18 is driven by volume increase in most of our businesses, better cost structures due to scale and technology up-gradation and stable to positive market conditions. The rising trend in input prices particularly coal, salt and cane could create some pressure on margins going forward. The finance cost are stable, though it has some seasonality element. Borrowings are low in Sept./Oct. but move up towards year end as sugar season progresses. Tax Rates will be higher and is likely to remain high with phasing out of exemptions.

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

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the Question-and-Answer Session. The first question is from the line of Manish Ostwal from Nirmal Bang. Please go ahead.

Manish Ostwal: I have a question on the Chemicals business. How do you see the overall Caustic Soda market globally and domestic market? Secondly, the current price increase can sustain in the market?

Ajay Shriram: Caustic Soda is actually two products; Caustic Soda and Chlorine. So the price of both these products have a link with what the consumption of each of them are. We in fact are seeing next couple of quarters to have a stable price on the Caustic Soda front. On the Chlorine front, it could be little pressure here and there, because the demand for Chlorine also fluctuates and you cannot store too much Chlorine. So that depends on the capacity utilization of the Chlor-Alkali plant. But at an overall if you look at it in terms of what we call ECU which is the combined price of both Caustic Soda and Chlorine, we feel that it should be stable for the next few quarters.

Manish Ostwal: Second point sir, on Sugar business, what is the total inventory valuation on 30th September?

J.K. Jain: It was valued at Rs. 2,970 per quintal and the inventory was 3.9 lakh quintal.

Moderator: Thank you. The next question is from the line of Sumant Kumar from Emkay Global. Please go ahead.

Sumant Kumar: As we know for Bharuch plant for Caustic Soda, we import coal from Indonesia. So we would like to know what is the contract quantity/ price and how many months we have coal contracted?

Ajay Shriram: I will be honest; we do not look at any long-term contract because international price fluctuates so much, so the business has to take a view of what the projection on coal price is. We just want to ensure we have adequate stocks with us, so we do not have any downtime in our power generation plants. But international prices of coal in fact in last two months have gone up a little bit. So we actually take a varied view on that, I do not know what is the exact stock we have today lying with us and what is it at the factory, but I can tell you that we are having adequate to stock of good quality coal.

Sumant Kumar: So whatever coal we have it is at old price?

Ajay Shriram: We keep buying, old means it could be one month old, so it is a continuous process.

Sumant Kumar: In spot market we do not have any contract with any seller?

Ajay Shriram: We keep buying from various people where we get a good price and collect delivery at our time. We have found in the past that where we want to get into any long-term commitment for price because it is such a fluctuating price product that you can get the ups and down both. So we do not want to look at any long-term commitment. We are not in the business of taking a punt on the price that is going to go up or down. So we rather ensure that we have adequate availability with our policy of a couple of months stock at any given time.

Sumant Kumar: Why I am asking is because the caustic soda price has increased. So whatever the price increase in coal has reflection in your cost structure in the current quarter or it is going to reflect in Q3 or Q4?

Ajay Shriram: I will be honest; some of the price increase is already reflected in what happened in the last couple of months, it has already come in there. If the coal price goes up more, there will be an impact on the margins in the next quarter and the next quarter after that. But the good thing is that the caustic soda prices are fairly stable and firm. So we do not expect the impact to be too much.

Sumant Kumar: Compared to previous quarter, what is chlorine loss or profit per ton this quarter?

JK Jain: Chlorine is attracting negative price. As you know, we do not share the details of individual thing because that is not material. What is important is as CMD said the ECU realization which you would notice from the detail has gone up compared to Q1.

Sumant Kumar: The second thing is regarding Sugar segment. Due to realization and cost of production, is sugar price going to sustain and at what level it is going to sustain?

JK Jain: What we have reported, you will see in the presentation that the margin for Q2 was same as last year Q2, it hasn't changed, the prices did move to compensate the cost of production increase. As of now the price of sugar is still hovering between Rs. 36-37 / per kg. As far as cost of production for new season is concerned, you are aware, cane cost has gone up by Rs.10 / quintal. But it is too early to comment on the recovery. Therefore that will determine the ultimate cost increase.

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

Dheeresh Pathak: Sir, I am referring to Slide #16, there in the Chemicals segment, these are ECU realizations, right?

JK Jain: Correct.

Dheeresh Pathak: But then revenue divided by sales, they do not match the realizations, so what is the difference?

JK Jain: Two things; one is besides ECU, we sell Flakes and SBP and Hydrogen also. So the difference comes from there, but they are not a very material number and they do not change so much.

Dheeresh Pathak: What is the current capacity at the two locations and can you just give the summary of the current capacity now at the two locations?

JK Jain: So the combined Chlor-Alkali current capacity is 1345 TPD now which will go up as CMD said we are undertaking expansion of about 350 tons which will get completed by September '19 in phases; the split is 330 TPD at Kota and 1,015 TPD at Bharuch.

Dheeresh Pathak: Let us say a new project, 146 TPD at Bharuch and 84 TPD at Kota, so that is what you refer to when you said 350 TPD or this is after that?

JK Jain: We are implementing two expansions at Kota; one for 80 tons which will get completed in August-September '18 and the second expansion of 80-85 tons will get done in June '19 and similarly we are undertaking expansion of 162 tons at Bharuch, end capacity will be 1660-1670 tons by September '19.

Dheeresh Pathak: Which will increase by another 220 TPD by FY'20 end, right?

JK Jain: No, there is no expansion thereafter; 1660-1670 TPD by September '19 is the final as per the present plan, unless we announce more plans or something.

Dheeresh Pathak: This is all Brownfield expansion, right?

Ajay Shriram: Yes.

Dheeresh Pathak: Then at 1670 tons, would you exhaust all your capability to do expansions or you would still have scope for further Brownfield expansion?

Ajay Shriram: Putting it frankly, I do not think anything is final unless you take a policy decision not to expand. As the management, we will continuously keep looking at technology upgradation and expansion when it makes sense. Whether it is Kota or Bharuch, I do not think we will reach a position where we are blocked for expansion further, but technology is also changing, upgradation is happening, so depending on the situation of the market and depending on our own position, the board will take a view.

Moderator: Thank you. The next question is from the line of Aman Sonthalia from AK Securities. Please go ahead.

Aman Sonthalia: Many of the analysts of the view that sugar industry we will be in a problem in 2018-19 due to very high production. But do you think the government will export the surplus sugar and will allow the sugar price to remain stable and with higher recovery, higher crushing and this higher income from cogen and distillery, the profit of the sugar industry will be stable going forward?

Ajit Shriram: As far as '18-19 season is concerned, it is just too early to forecast anything right now because this is a agro crop and be it India or be it worldwide, it is very-very difficult to give any comment regarding '18-19 production. As far as '17-18 is concerned, our production estimate is roughly 25 mt and so is our consumption estimates in India. So we had an opening stock of 4 mt on1st of October 2017 and we expect the same level of opening stocks on 1st of October 2018.

Aman Sonthalia: So in case of any over production, do you think the same government in Maharashtra, Karnataka and Centre, they will help it out?

Ajit Shriram: No, we are hopeful of implementing the Rangarajan formula for cane price fixation and having the same government in the center and the same government in the states will make a difference.

Ajay Shriram: I will just add one more point to what Ajit mentioned that as a policy reason why we are in fact putting up a distillery and plan to expand it further in 2019 we are augmenting our cogen power generation capacity, it is to balance our entire portfolio in the sugar business so that we have a value addition happening on all three product lines and not only sugar. It is to give stability further to the sugar business.

Aman Sonthalia: Like in 2009-10, 11, 12, the cyclical nature of the industry, do you think that it is over and it will be more stable let us say than in the past?

J. K. Jain: We do not know about industry, what we are talking about is that our business will be stronger because we will have all these three revenue streams.

Moderator: Thank you. The next question is from the line of Rajul Doriwala, an Individual Investor. Please go ahead.

Rajul Doriwala: Sir, my question is when you are doing all your caustic soda expansions are Greenfield, so in case somebody is trying to do a similar expansion in a Brownfield, so what kind of edge or what kind of benefits do you have when you are expanding Greenfield, kind of any rough numbers, say 20% or 25% of the cost?

Ajay Shriram: Let me put it this way, our expansions both of them at Kota and Bharuch in Gujarat are all Brownfield, they are not Greenfield because we already have existing plants at both these locations and in Gujarat we already have power generation capacity also. In Kota, we are changing our power plant, we are replacing 50 megawatts of old power plants with the new plant of 66 megawatts. We will have additional power in Kota also, so ours is also Brownfield expansion with having the basic infrastructure already in place.

Rajul Doriwala: As I understand, we are one of the lowest cost producers of caustic soda, so we have some kind of a cost per ton kind of an estimate and by how much we may be lower cost compared to other producers in India?

Ajay Shriram: I am not sure where this figure came, I am not sure that we can say the lowest cost. What our objective is to be competitively priced and always look at new technologies or sourcing of our raw materials to reduce our cost of production on a continuous basis. As an industry, no one knows these are the cost of production, so we do not know what is the cost of other people. But we can say that we are competitive based on what we estimate as the cost of production from the sourcing of raw material, from technology, what is the capacity and capability of the plant. We are running our plants very efficiently. Our sourcing of materials is fairly solid, so we would be among the lower cost producer. I do not think there is any possibility of saying lowest. We have the latest technology and we keep upgrading that along with the suppliers of our electrolyzers from Japan, so we keep upgrading that.

Rajul Doriwala: For caustic soda at the end of the day, it used to be or maybe it is cyclical commodity, so right now we have been investing a lot and we have seen the good fruits from those investments, so the more investment that we are making, do you have any view on where we are in the cycle in terms of caustic soda cycle turning for bad and do you have any understanding on where we are in the cycle?

Ajay Shriram: It is very difficult to say and I think our estimate in next few quarters should be satisfactory. The prices should remain firm internationally and nationally, but I think predicting commodity cycle is very, very difficult.

Rajul Doriwala: If we look at publicly available information of caustic soda prices internationally, if we see that from October 1 onwards, it has increased about 30%, so can we relate our sale prices to the spot prices of the caustic soda or we are in a longer-term contract and that will decide the prices at which we sell it?

Ajay Shriram: No, I think the issue is because you are talking of only caustic soda, but the impact on the company is on the ECU, which is the price of caustic soda and chlorine, and as I mentioned earlier, chlorine is at negative price so I think that also fluctuates the caustic soda price, when the chlorine price fluctuates so I think on an ECU basis, we are stable and we are continuously seeing how we can improve it. We already have four or five companies who are pipeline buyers of our chlorine in our Gujarat factory, so with them we have a flexible long-term contract on chlorine supplies based on the market prices, so we are trying to hedge our bets from all corners to make sure that we are in a stable position on the ECU realization.

J. K. Jain: Even so, caustic we do not enter into long-term price contracts, so prices are related with the market essentially.

Moderator: Thank you. Our next question is from the line of Anant Jain, an Individual Investor. Please go ahead.

Anant Jain: Sir, my first question is on our capacity expansion on the sugar side, you have already mentioned that because we want to balance the portfolio in sugar, so that all three revenue streams including co-gen and ethanol could contribute, personally what I would want to understand is that we have had a sugar portfolio and we have gone through multiple cycles. In your experience, can you tell us that what is return on capital expectation over the sugar cycle plus the other question that I have is that only on the sugar, there are absolutely no entry barriers and our future investments in sugar, what would it be driven by?

Ajit Shriram: Essentially as far as the sugar investments are concerned, these are again Brownfield investments in our Hariawan unit and we are increasing the size of our distillery, we are increasing the size of our co-gen and sugar, so basically with the anticipated increase in our cane area which our cane team is working on very, very strongly. We will crush the entire cane within the sugar season and as far as costs are concerned, the fixed cost will be absorbed over a larger volume, so the business will become more cost efficient.

J. K. Jain: Also if I may add the industry data for past few cycles indicate that an integrated player is able to have around 15 plus/minus some percentage return on capital employed. There may be exceptions in one or two year when the industry goes through bad period. The other part which we have factored in is the change in industry structure which, as you must be knowing the recovery in UP has moved almost to Maharashtra level. Also the governments have been more rational in policies compared to what they were earlier, so therefore, we are expecting reasonably good returns from the sugar industry going forward and that is the reason of going ahead with the expansion.

Anant Jain: Sir, the second question we have not expanded our PVC carbide capacity, any reasons around that because on return on capital perspective that seems to be a pretty decent business I would say?

Ajay Shriram: We are looking at all plants, we in fact went through about six to seven years ago an expansion in our carbide and PVC plant, so in terms of price realization we looked at Chlor-Akali and sugar right now, but at the opportune time we will look at all plants and way to expand.

Anant Jain: Sir, we know the ECU realization from the presentation, can you also share the breakup between chlorine and caustic soda?

J. K. Jain: That we have not shared, so it will be difficult, we do not have that right now.

Anant Jain: Because you used to share, I remember in the previous quarter also you shared those numbers?

J. K. Jain: Not the breakup of caustic/chlorine, in any case as I said we do not have it right now with us, so it will not be possible to share that, but as CMD said, chlorine is running negative realization for last few quarters.

Anant Jain: The last quarter or last quarter you said it is around Rs. 8000 a quintal or a ton I do know whatever the major met unit, but has it improved from there is what I wanted to know because that is the lowest level in the last seven to eight years?

J. K. Jain: It is possible that we may have given a broad range that it is running at negative of Rs. 8000/- and it has improved the little bit, but as I said we do not have the exact numbers here.

Anant Jain: The other question is mainly on the tax rate, in this quarter we have had a tax rate quite high, so is this going to be the going rate from here on?

J. K. Jain: Which is what we mentioned in our statements before that the tax rate will remain high going forward as the exemptions which were available March 31, 2017, have been done away with.

Anant Jain: The last question is on the Bioseed side, what is the outlook I want to have a kind of a long-term two to three-year view of the Bioseed business in terms of any area where we are focusing, what are the new launches and what are the key quarters, like India we know the first two quarters are key quarters because of the cotton and what are the key quarters of the international business?

J. K. Jain: Two to three things, one is in terms of focus crop, we are focusing on cotton, corn, paddy, and vegetable, those are our focus crops. Most of these crops are kharif centric except vegetables and some amount of corn which goes in Rabi also. As far as international is concerned, there is different seasons in different countries and some of these countries have two seasons, so it will be difficult to say that this is the quarter where they have more sale. I think is more evenly spread out combined than India.

Anant Jain: What kind of launches can we expect on the cotton side in terms of new BT cotton seed in the next two to three years, which could drive our market share gain and any strategic on the southern side of the country on the BT cotton because that is a bigger market western and southern India?

J. K. Jain: We have pretty strong research program on all these crops and we keep testing products across geographies for all these four crops that I mentioned. Depending upon what is the product performance and the market readiness, we decide to launch before a year in advance, so you do not decide the launch three to four years in advance about a product, but at any stage there are lots of products which are under testing because of our strong research program and this year also we are testing the products.

Moderator: Thank you. Our next question is from the line of Ritika Jalan from Narnolia Securities. Please go ahead.

Ritika Jalan: Most of my questions have been answered, how much is the CAPEX out flow is pending in terms of ongoing capex?

J. K. Jain: The CAPEX that we have announced is Rs. 850 crore which has just been announced, so the cash flow against that will start now, they have just been approved by the Board. Now the other part of CAPEX of Rs.350 crore which are under implementation which will all be over by about September '18, so in another six months to seven months, it will all be over.

Moderator: Thank you. Our next question is from the line of Dikshit Mittal from Subhkam Ventures. Please go ahead.

Dikshit Mittal: Sir, I wanted to know current ECU realization because second quarter you mentioned it is around Rs. 28, so what will be the current level?

J. K. Jain: It has marginally moved up in October compared to this, but the prices do fluctuate, so for the quarter as a whole it is difficult to give a futuristic number, but it is marginally improved in October compared to the Q2 number.

Dikshit Mittal: Sir, secondly on this sugar CAPEX, so do you see any structural improvement in UP based sugar mills like that we have decided to expand the capacity or is it like from a long-term perspective, you want to add?

Ajit Shriram: From two perspectives, as was mentioned earlier the competitiveness of the UP sugar industry has improved and is now comparable with the Maharashtra as far as cost of production is concerned, number one. Number two, as far as our portfolio sugar and its byproducts are concerned, we are adding on co-gen as well as ethanol or distillery to manufacture ethanol as well as other alcohol products and spirits, so we are not dependent on only bagasse and molasses, we are planning to value add on this, so that will make our business more stable and stronger.

Dikshit Mittal: Anything from a structural point of view, do you see anything has changed for the industry or no, one thing is you mentioned that recoveries have stepped to Maharashtra level, but in terms of policy thing like sugarcane pricing and all, do you have any indication from the government that in future it will be more rational like linking sugarcane as well as sugar prices?

Ajit Shriram: If one sees the sugarcane pricing over the last four or five years, for four years the sugarcane price was kept constant at Rs. 280 per quintal, and even this year, the sugarcane pricing has been raised by only Rs. 10 per quintal, so I think the main focus is to make the sugar industry more stable. The focus is to ensure that there are no cane arrears to the farmer at the end of the season and to ensure that all the four components of the industry which is the industry, the farmer, the consumer, and the Government have a stable sugar industry.

Dikshit Mittal: You mean to say that Government may allow at least some decent kind of ROCEs every year to the sugar industry from now on?

Ajit Shriram: We are hopeful.

Moderator: Thank you. The next question is from the line of Sachin Kasera from Lucky Investment managers. Please go ahead.

Sachin Kasera: Sir, just two queries, one this quarter you have produced close to 103,000 tons of caustic soda, so my question was we obviously have expansion going on, but with the existing capacity itself, do you think we can achieve closer to 115,000 ton and 120,000 ton if we are able to find enough demand even for chlorine technically is my question?

J. K. Jain: We have potential to go another 10% Sachin based on existing capacity vis-a-vis Q2 production.

Sachin Kaera: Going by the trend that you are seeing, that the caustic market is very strong, so then I think the only challenge would be one would be technical whether how fast you can ramp up and secondly can we dispose of the chlorine, do you think that either in Q3 or Q4 you should be able to hit that peak of 110, 000 ton to 112,000 ton?

Ajay Shriram: We are working on that, chlorine is the challenge because chlorine market keeps fluctuating and you should not forget, I think in March April next year that the Aditya Birla Group is also coming in with an expansion, so that is going to have an impact in totality on the industry and it takes time, but fortunately the chlor akali industry is growing at 5% to 6% in the year it has in the past, so I think that has been the positive sign. We are also trying to have our tie ups for our chlorine going out, our Aluminum Chloride plant is also coming up which will be commissioned in by June next year so that it will give us a buffer again for chlorine outlet, so that will be an advantage also.

Sachin Kasera: My second question also you mentioned that the current ECU are closer to around Rs. 37 to Rs. 40 compared to Rs. 28.3 that we had for Q2, is that a correct understanding of the market?

J. K. Jain: We have not seen that kind of ECU still, Sachin. We wish it is there, but we have not seen that kind of ECU.

Sachin Kasera: Sir, my next question is regarding the sugar, considering that we are also going for an expansion, so are we looking at a further increase in production this year over last season and what is your sales, should we be at least 10% to 15% higher?

Ajit Shriram: As we mentioned earlier, last year our capacity utilization was roughly 90% in terms of cane crush, so we anticipate about 100%, a little over that in the current sugar season, and as I mentioned earlier that our cane team is working very hard to increase cane area and productivity further with the farmers and the expanded capacity which we are putting up will absorb the additional cane.

Sachin Kasera: Roughly around 9% to 10% higher production is what we could probably see this year vis-a-vis last year?

J. K. Jain: As of now, yes, but as you know in agriculture it is difficult to estimate, but that is what we are expecting.

Ajay Shriram: The other factor, besides the cane quantity crush, is the recovery. So frankly because of the late rains in UP recently, etc., we will have to see how it moves forward.

Sachin Kasera: Sir, but what is your initial sense around recovery?

Ajay Shriram: It is too early, right now.

Sachin Kasera: Do we intend to have a higher percentage of early variety crush this year vis-a-vis last year?

Ajit Shriram: Yes, it is difficult to give a number, but yes, early variety will be higher than last year.

Sachin Kasera: What was it last year?

J. K. Jain: It was about 60% to 65% of the area was under 238 which has gone up, but we do not have a precise number right now about what the area is this season. But has gone up compared to last year.

Ajit Shriram: It will be 65% of 238 and other early varieties.

Sachin Kasera: With the type of effort that we are doing, is it possible that in the next three to four years, we could take this ratio closer to 85% to 90%

Ajit Shriram: It is not desirable to have dependence on one variety only, so we in fact want to endeavor to make an effort and have two to three different varieties in our entire area. If there is a pest attack or if there is a termite attack or anything of that sort, we do not want to have an overdependence on one particular variety and then we could have a negative consequence.

Sachin Kasera: Last time we had a very large Rs. 1000 crore CAPEX in sugar and then obviously we had little difficult time in that business. Again now, we have almost two or three good seasons for sugar and now we are committing a large Rs. 500 crore CAPEX, so how confident are you in terms of that we are not again getting the cycle wrong this time because again Rs. 500 crore is one of the largest CAPEX you would have done in the last three to four years, so if you could give your sense on that?

J. K. Jain: Two to three things are different from the last expansion. In last expansion, which we had done in 2007-08 was primarily on sugar capacity expansion and it was in virgin area, means the cane was not available, we had to undertake effort to expand the cane area. I think that time also we had indicated that it takes long time to expand the cane area, therefore, capacity utilization will take time. Unlike last time, this time, we have a ready cane area and the cane intensity is pretty high and rising very fast, so therefore, we do not expect too longer a period for capacity utilization. The second change is that we were not integrated last time, whereas now we are fully integrated on bagasse and molasses stream, so therefore, scale gives you benefit on the byproduct as well which is not dependent on sugar cycle, and third fundamental change is with respect to the UP recovery which has moved up and is comparable to Maharashtra, so we are more competitive compared to them, so given that we feel that we should not have the same kind of issues, but commodities, you can never predict the exact thing.

Ajay Shriram: I will just add one more point, if you recall in the year 06-07 etc., it was not only our group that invested in sugar, but at least 30 new factories came up in UP and there were also Brownfield expansions in the existing factories. So the capacity expansion in UP per se increased dramatically in that period because of the Government policy of the incentive scheme SIPP 2004, that was a sugar incentive promotion policy, which was brought in 2004 and based upon that a large number of groups and single factories witnessed expansions and putting up new factories, so that is the fundamental change, that this time it is not an industry wide expansion that is happening, it is only our group that is expanding.

Sachin Kasera: Can you give this Rs. 500 crore breakup, how much is towards distillery, power and sugar?

Ajit Shriram: We gave that, roughly Rs. 360 crore is towards sugar and power and Rs. 140 crore towards the distillery.

Sachin Kasera: Regarding agri input, the business is still not showing the type of traction that we would like. What are the steps management is taking especially on the value-added products and on the seed so that this can also start to perform in line with other businesses over the next 2-3 years?

Ajay Shriram: We have got 3-4 verticals in our farm solutions business. If you recollect, we have already actually stopped DAP/MOP bulk fertilizer trading because we felt it was taking time and too much money and the ROCE levels were very low. And of course the issue with all these fertilizer product is the outstanding of FICC from the government also, so all that combined, we have taken the corrective step already. And the value-added part of it, we are working more intensively to get more products, get some new sources of getting our agri inputs of how to carry those forward so that we can grow this business further. We do feel agriculture that way does require a lot of knowledge and quality inputs at the right time. So we are looking at the value-added in terms of growth promoters. We are also looking at the Crop Care Chemical business. Seeing what we can do and what we can take up more actively and we are looking at seeds now in their own vertical of wheat and couple of other products. That is also growing well in their market area, unlike Bioseed is separate geographical market; this is a separate geographical market. So all this combined should give this business stability also.

Sachin Kasera: We have seen a good traction in the Fenesta performance in last 2-3 quarters. But the order book has come down, do you think this performance may start to go down a little or you think this numbers are sort of sustainable by the type of momentum you are seeing in the business?

Vikram Shriram: Everyone is aware about the difficulties that the real estate sector is going through. The only feeling is that if the real estate clears, comes out stronger financially, then hopefully in 6 months to 12 months down the road, the turnaround time and the financial capability of the real estate players should improve. So the longer cycle time between order booking and completion or installation may come down. So that is a hope that in the longer term, stronger real estate players will be able to book, place orders and execute their projects in a faster cycle time. Otherwise, yes, it could be flat or it depends on how the real estate sector performs 6-12 months down the road.

J. K. Jain: But, just to add that 70% of our business is retail.

Sachin Kasera: I was talking about both retail as well as the registration business.

J. K. Jain: I was just saying 70% is retail, which is not coming down; it is constant.

Sachin Kasera: So, the outlook on retail is better than projects, as we stand today?

Vikram Shriram: It is flat. It is 5% up, as was mentioned earlier, so it is marginally up, but hopefully that will also pick up in due course as it was growing at 20% plus in the earlier years.

Moderator: Thank you. The next question is from the line of Harsh Saraswat from Girik Capital. Please go ahead.

Harsh Saraswat: My question is on caustic soda, what are the major reasons for prices firming up internationally. Any major shutdowns in China and USA?

Vikram Shriram: There are many supply demand issues, which is the main reason why the prices normally move up or down in all commodities. If we see worldwide, you see most of the economies, US itself had good GDP growth. Similarly, Europe, Japan, so all over, the growth has been good across many countries that is why the Chlor-Alkali business is doing well.

J. K. Jain: And supported by two more factors that China is restricting production because of environment constraints and Europe is phasing out their mercury based capacity, so that is causing some kind of shortage immediately.

Harsh Saraswat: And the Harvey hurricane in USA caused few capacities going out?

J. K. Jain: For a few months, yes.

Harsh Saraswat: So have they been restarted?

J. K. Jain: What we understand is most of it has been restarted, there may still be some small capacity which may be getting started.

Harsh Saraswat: That is basically because of the demand supply mismatch. But in India, we have enough capacities to meet the demand. So do you think these prices will sustain at these levels?

Ajay Shriram: This business is growing at about 6% a year, which is being consistent. So that is the positive sign. And we expect some stability to maintain because ultimately we have to match the international landed prices, because people have the option to import also. So we feel next couple of quarters should be fairly stable.

Moderator: Thank you. Our next question is from the line of Pratik Vora, an individual investor. Please go ahead.

Pratik Vora: Wanted to understand management view or rationale on diversifying into so many business verticals like Chloro Vinyl to agri to cements, Fenesta, Hariyali Kisaan Bazaar. So what is the rationale of spreading into so many businesses or verticals?

Vikram Shriram: You know, if we look back last 25 years, we inherited virtually all the businesses we are in, except one or two that we have added now which is Fenesta and we have had a major portfolio and exposure to the agri sector, from day one and we feel that for India, the agri sector is a strong forward looking sector with 65% of our population there, with issue of food security, with the needs to actually provide better technology and products to farmer to make the agricultural activity more economically viable. That is how we got into agri portfolios in a related manner of the agri business. So that is how we got into the agri. Regarding caustic soda, chlorine, we have been in it from day one, of course we have expanded capacity dramatically since then, but we think that is a good area to grow in. On the PVC, we have already been there from day one. We were looking at some value-added businesses to PVC, that is the way we got into Fenesta and we think that it is a good business to grow. It is a good vertical to grow. You are right, we did get into Hariyali because that is again retail for the rural sector, it is for rural India and we thought that it will be a good business to get into but then the challenges were just too many. So the management took a view that it is better to wind down the business and not get stuck on just because you are there, we must do it or any ego issue and let us be practical. So we took a view to wind it down which we did and I think it is a very good decision, otherwise we would have been still pushing a retail business. Retail businesses take many years and a rural retail business is even more complicated because of the ticket size being small because of the logistics management being more difficult. Logistics cost being higher, etc. So we have actually inherited lot of these businesses. We have looked at a couple of more which makes sense, which we got into. So that is the philosophy because you want to look at each vertical in its own right and we are a conglomerate, DCM Limited has been a conglomerate even prior to 1990 when the restructuring took place and lot of those businesses, which were in DCM Limited came into our portfolio. So that is how we are in so many businesses.

Pratik Vora: Are we planning to list any of these verticals separately also going forward to unlock the value or to get a better valuation?

Vikram Shriram: No. We have not looked at that. We are still seeing as you heard that in the last couple of years and next couple of years, we are investing lot of money in many businesses, we think there are synergies, the way they are even today and we are not looking at branching them out.

Pratik Vora: For the upcoming expansion of Rs. 850 crore, have we also squared down on the capital structure? Like how much debt or how much of it could be funded to internal accruals?

J. K. Jain: See, as we have mentioned, our cash generations are pretty strong, so we don’t expect substantial debt increase to fund these particular capex. I think we will be funding largely through internal accruals.

Pratik Vora: Okay. So, the cash on the balance sheet as of now is around Rs. 750 crore whereas the debt is around Rs. 670 crore.

J. K. Jain: There are two reasons, one is we mentioned that there is seasonality where September-October, the working capital requirement goes down and it builds thereafter as sugar commences. And the second is the surpluses that we are generating and we are keeping it for investments.

Pratik Vora: So there won't be a significant amount of debt load up from here for the upcoming expansion?

J. K. Jain: Yes, for these projects.

Moderator: Thank you. And next question is from the line of Rupen Patel, an Individual Investor. Please go ahead.

Rupen Patel: You just mentioned the gross debt level. Currently, you are at Rs. 673 crore and you have a cash of around Rs. 750 crore on the balance sheet. So going forward, with strong internal accruals also, which you are generating and the cash you are having, what do you expect the debt level to be by March? Do you think it will go down further or because you are seeing there is a seasonality involved and therefore it will remain at these levels?

J. K. Jain: You are right, because of seasonality involved, March debt maybe a little higher than the gross debt, which exists right now.

Rupen Patel: Because you will need working capital for the sugar and all that.

J. K. Jain: Sugar and subsidy payments will determine the debt level, because subsidy arrears build up during the year-end.

Moderator: Thank you. Our next question is from the line of Anant Jain, an Individual Investor. Please go ahead.

Anant Jain: How are we looking to manage the excessive cash flows? What would be a debt equity mix that we are looking on the longer term? It is probably the first time in lot of years that we are at cash positive. So what would be our debt equity mix or are we going to remain at very low level of debt from here on, maybe a working capital debt?

J. K. Jain: Debt equity is a little flexible number depending upon the investment opportunities. We have a pretty healthy debt equity even right now. But more than debt equity, the other parameters we track is the debt to EBITDA, which we would like between 2 and 3 at all points of time.

Anant Jain: Are we looking to increase the dividend payout ratio and do we have any dividend payout ratio defined as of now?

Ajay Shriram: The board took a view that is why we gave this interim dividend of 200% just now. If you recollect last year also, we have been doing interim dividends over the past. Being capital intensive type of business company, we don't want to take it too high, but the board has discussed this briefly and we talked about ratios which will move up and down depending on the capital requirements of the group at a particular time and depending on the cash flows which are available. So I don't think we have really taken a view what it should be like.

J. K. Jain: We already have a dividend policy on our website; I would suggest you go through that. We follow that particular policy. Board takes a view based on that policy.

Anant Jain: Looking at our cash flows for next 2-3 years, we are looking at cash from Rs. 2,000 to 3000 crore in the next 2-3 years. Any larger CAPEX plans that are we looking at?

Ajay Shriram: The board will take a view depending on the projects, depending on the opportunities because we are not just looking at investing, we want to make sure we invested correct and rightly, so that is why we are perpetually always looking at how we can evolve our businesses, how we can be more competitive, how we can upgrade technology and how we can upgrade capacities. We have nothing on the drawing board right now as to what is next. But yes, projects have always been discussed and debated within the group.

J. K. Jain: And you know we have just announced project of Rs. 850 crore, which means we are continuously looking at projects.

Moderator: Thank you. Our next question is from the line of Rajul Doriwala, an individual investor. Please go ahead.

Rajul Doriwala: For the business of Fenesta, what kind of an outlook do you have for say next 5 years? I understand it will depend on the real estate recovery and the growth of the sector, but do you have any high level numbers on the outlook for Fenesta?

Vikram Shriram: Not numbers in specific, but the outlook is positive linked to the growth of real estate, linked to the value proposition of the product and linked to the benefit that the customer sees by using Fenesta products rather than ordinary products. So long-term outlook is positive. At present because of various factors, last 6 months to 9 months and maybe for a few more quarters, it may be a little more turbulent, but ultimately it should come back on track and should be quite bullish.

Rajul Doriwala: We have been investing a lot and patiently waiting for that business to be profitable. So how long till you expect the return on capital of that business to be about 10% plus?

Vikram Shriram: It is already cash flow positive, and it has not been capital-intensive business. In fact, the investment in the Fenesta business is negligible. It will be a very high number if you were to look at ROCE number.

Moderator: Thank you. Ladies and gentlemen that was the last question. I now hand the floor back to the management for closing comments. Over to you, sir.

Ajay Shriram: Ladies and gentlemen, we thank you for your participation in our Q2 & H1 FY18 earnings conference call.

As mentioned, we have been focusing on increasing scale and competitiveness in our manufacturing businesses. Simultaneously, in our Bioseed & Fenesta businesses, we are focusing on offering better products and services to our customers and thereby grow volumes. These efforts are leading to satisfactory growth and financial performance in all our businesses. The investment projects under implementation and announced, in Chemicals and Sugar will consolidate our position in these businesses and contribute to growth in volumes and profits from FY 19 onwards. This is over and above the benefits from expansions completed last year. We will continue to look at growth opportunities to ensure sustainable growth in our earnings.

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