DCM Shriram Limited

Q2 FY 16 - Conference Call Transcript
November 06, 2015

Moderator: Ladies and gentlemen, good day and welcome to DCM Shriram Limited Conference Call hosted by the management to discuss the performance of the company during the second quarter and half year ended September 30th, 2015. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference please signal an operator by pressing * then 0 on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Siddharth Rangnekar of CDR India. Thank you and over to you, sir.

Siddharth Rangnekar: Good afternoon and thank you for joining us on DCM Shriram Ltd.'s Q1 FY16 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 the 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 operations for the quarter ended September 30, 2015 and the opportunities going forward. Over to you, sir.

Ajay Shriram: Thank you Siddharth**.** Good morning ladies and gentlemen and a very warm welcome to DCM Shriram Limited's Q2 and HY FY 2016 Earnings Conference call. Before we start, on behalf of DCM Shriram and on behalf of Vikram, Ajit, JK and myself, we would like to wish you a very Happy Diwali and All the Best to you and your families.

I will take this opportunity to share with you insights into the company's operating performance and plans, following which Vikram will take you through the financial highlights of the company for the quarter and half year ended 30th September, 2015.

The second quarter of FY 2016 had been challenging given the weak agriculture dynamics led by the second successive year of low monsoons and continued softness in global agri commodity prices. The product prices for almost all our products, i.e Chlor-Alkali, PVC, Sugar and Cement have also been lower. The company's cost optimization measures over the last couple of years, as well as our diversified product portfolio has helped in delivering a satisfactory performance.

Now let me take you through our business wise highlights. Earnings of the Chlor-Alkali business improved, led by higher volumes along with deficiency improvement for key cost elements. The realizations have softened by about 4% YoY. Earnings for the Vinyl business declined despite higher volumes primarily due to a 15% YoY fall in realizations. Realization in both the businesses have declined Q-oQ by about 4% and are currently stable.

Power is a major cost element in these businesses. Our Chlor-Alkali facility at Bharuch has witnessed low power cost due to low cost of imported coal. However, Chlor-Alkali and Vinyl facilities at Kota were impacted by higher power cost due to the Govt.'s budgetary increases in coal freight and various duties imposed by the Central and the State Govt.

The company's focus on cost optimization has helped in maintaining reasonable margins even with lower product prices. We continue to take further steps to optimize the material and conversion cost. Expansion of Chlor-Alkali facility at Bharuch and planned investments in cost savings measures will further strengthen the competitiveness of this business.

The Sugar business received Rs.20 per quintal of sugarcane subsidy amounting to Rs.60 crores during the quarter, with this the entire subsidy of Rs.85 crores under the UP State Sugarcane Policy for the sugar year 2014-15 has been received. The business even after taking into account this subsidy has a negative margin of over Rs.520 per quintal. Sugar prices have firmed up over the last couple of months but are still well below the costs. The industry is pursuing with the government the need for urgent measures to restore viability of the sector on a sustainable basis and ensure timely payments to the farmers.

Kharif 2015 turned out to be another challenging year for the farmers and the agri businesses. The southwest monsoon during the season stood 14% deficient with erratic distribution. Strong El Niño phenomena is being witnessed in Philippines, Vietnam and Indonesia as well. Key domestic markets such as Punjab, Haryana, Eastern UP, Maharashtra, Telangana and Andhra Pradesh had significant deficient rains that hurt demand for agri inputs this season.

Weak farmer sentiment was further accentuated by low crop prices. The acreage under hybrid seeds in our key crops declined along with shift in sowing patterns. This has led to lower earnings in our Shriram Farm Solutions and Bioseed businesses. The business has intensified its marketing initiatives, is improving its product portfolio along with the distribution network to enable strong growth for the business in the medium-term.

The fertilizer business witnessed increase in revenue and earnings vis-à-vis last year led by higher volumes. The earnings increase during the quarter was limited by tightening on energy norms under the new urea policy which came into effect from 1st June, 2015. The subsidy continued to be an area of concern with higher prices of pooled gas adding to the outstanding.

The company is focused on improving energy efficiencies to maintain margins in this business.

Our Fenesta Windows business continued to gain traction exhibited by the robust gain in sale volumes in our retail segment during the quarter. Order book in both the retail and project segments had increased over the corresponding period last year. Business continues to maintain positive PBT levels.

In line with our policy to optimize cost structure and maintain them in line with best in the world, the Board has approved a capital expenditure program of Rs.73.2 crores in our Chlor-Alkali business. This is in addition to the ongoing projects of Rs.534 crores in our Chlor-Alkali expansion project and 118 crores in our Sugar Cogen project. All these projects will start adding value to the company from full year 2017 onwards.

I will now request Vikram to take you through the financial highlights. Vikram?

Vikram Shriram: Thank you. Good afternoon ladies and gentlemen. I will now summarize the financial performance of the company. Total revenues for the quarter increased marginally to Rs.1,439 crores led by higher revenue in Shriram Farm Solutions, up 10% and Chlor-Alkali up 12%. Revenues in Sugar business declined 31%. PBDIT stood at Rs.121 crores during the quarter, up 30%. Excluding the sugarcane subsidy of Rs.60 crores in the current quarter and Rs.19 crores in the corresponding period, the PBDIT declined 17% to Rs.61 crores.

Let me now take you through our business wise performance.

Chlor-Alkali segment revenues in Q2 increased on account of rise in volumes driven by higher production of Chlor-Alkali as well as Vinyl business vs. same period last year during which there were scheduled maintenance shutdowns. Vinyl business recorded higher sales volumes on account of liquidation of inventories during the quarter. PBDIT margins in Chlor-Alkali business improved to 33% from 28% driven by better efficiencies as well higher volumes despite 4% decline in realizations. Margins in Vinyl business declined from 31% to 18% led by 15% decline in realization and increase in power cost.

Sugar revenues in Q2 were lower, lead by 8% decline in volumes and 25% decline in realizations. Excluding the cane subsidiary of Rs.60 crores, there was a PBDIT loss of Rs.1.5 crores versus a loss of Rs.9.4 crores in the same period last year. The loss for the quarter was lower as we had ‘Marked to Market’ sugar inventory in the first quarter this year and had taken a debit of Rs.40 crores on this account. For the Sugar Year 2014-15 total loss in sugar was Rs.154 crores at a negative margin of Rs.520 per quintal after taking effect of subsidy of Rs.85 crores received for the sugar year. The inventory at the end of September ‘15 was 2.1 lakh quintals valued at Rs.2,557 per quintal.

Shriram Farm Solutions’ revenues stood higher primarily due to higher revenue of bulk fertilizers of DAP and MOP up 30%. Margins were under pressure across bulk as well as value added inputs vertical driven by adverse agri dynamics due to poor monsoon. Higher capital employed was a result of high subsidy outstanding as well as longer working capital cycle due to cash flow constraints in the agri sector.

For Bioseed business Q2 is an off season, hence volumes as well as earnings are low vs. Q1. Carrying forward the impact of low monsoon, the revenue in India as well in International businesses declined by about 50% in Q2 versus same period last year. The lower sales also led to inventory write-offs relating to corn in some territories.

Fertilizer revenues and earnings increase during the quarter was on account of rise in volumes. Tightening of energy norms under the New Urea policy that came into effect from 1st June, 2015, weighed down on earnings during Q2 and H1 FY16. Subsidy outstanding are higher vis-à-vis last year led by higher prices of pooled gas.

'Other' segment's earnings improved substantially both in Q2 as well as in H1 FY16 on the back of strong performance by the Fenesta business. During Q2 and H1, Fenesta business' top-line increased by 19% driven by strong volumes witnessed in the 'Retail' segment. Order booking also witnessed strong growth in both Q2 and in H1 FY 16. The business operations are PBT positive.

The company's debt continues to be at very comfortable levels of Rs.432 crores on net basis. Cash generation is reasonable with H1 cash profits at Rs. 236 crores. This gives us confidence to invest in our new projects which will add significant value to the business.

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

Moderator: Thank you very much sir. Ladies and Gentlemen, we will now begin the question-and-answer session. Our first question is from the line of Shubhankar Ojha from SKS Capital & Research. Please go ahead.

Chintan: Yes sir, this is Chintan here from SKS Capital. Just wanted to get an update on your capacity in Chlor Alkali business. We see a current run rate of around Rs.1,200-odd crores from this segment, so what is your view beyond 2017 when the CAPEX is fully spent, what kind of revenue are we targeting from the segment?

Ajay Shriram: Today our capacity in our Bharuch plant is about 450 TPD and the additional capacity is going to be ~ 500 TPD. In addition in our Kota plant our capacities are 330 TPD. We are also adding a few electrolysers, so that will take the capacity to About 1300 TPD. Revenue increase will be corresponding to the increase in the capacity.

J.K. Jain: So we will add about 70% in terms of our capacity.

Chintan: In your Q1 call, you mentioned that the focus is now shifting from Regulated businesses and from the Sugar business. Also, what kind of improvement do we see in the Sugar business through government intervention. Also what plans do you have in the Urea business to maintain the profitability post the implementation of the New Urea policy?

Ajay Shriram: Out of our total business portfolio Chlor-Alkali we have already talked about of about expansion and our objective is that we continue expanding in a structured way, in a strategic way going down the line, that is the only way we can maintain our efficiencies and keep our per unit costs low on an ongoing basis. But additional to this, our Fenesta business is growing at about as you have indicated just now almost 20% it grew on quarter-to-quarter, so we are expecting this to continuously keep growing over the next three, four, five years at 20-25% a year. So that is one more business which is going to be continuously growing. Similarly our Bioseed business nationally and internationally we expect that to continue growing by 20-25% a year because of our strong R&D base which we have and that is a very strong asset we have within our structured business. Similarly, Farm Solutions we expect to be continuously growing again at 20-25% a year. So I think these four businesses are on a growth track. In sugar, even though we are not looking at increasing our capacity on sugarcane crushing but as we are moving in with the additional high pressure power plant this will give us additionally 18-19 MW to sell to the state which will help in terms of offsetting our problems with the sugar product per se, so that is also growing. And down the line we will look at other products in the sugar line.

Chintan: Sorry to interrupt, are we planning to set up distillery, we do not have any right now currently?

Ajay Shriram: We are studying this right now to see how it will pan out in the future depending on the government's policy for ethanol mixing with fuel. So these are all on the agenda, they are all on the drawing board but the other four businesses I talked about as well as our power plant expansion in sugar, these are already growing businesses. So I think our Group as a whole will continue to keep growing on a structured, strategic way down the line.

Chintan: And in Bioseed, what kind of growth are we targeting in the medium term?

Ajay Shriram: The plan is to achieve a 20-25% growth year-on-year, but as was seen this year and the last year with El Niño effect, particularly this year was exceptionally bad both in India and in the other geographies, so all the geographies suffered from the El Niño effect. So these are the kind of hiccups that come, you may be aware there was also some government clamp down in Maharashtra on cotton seed pricing this year, so that also had a negative effect. But yes, overall because of a strong research pipeline and a number of new products which have been introduced and are under introduction, we hope to achieve a 20% to 25% growth.

Chintan: On urea, on the energy we are not investing any to improve our profitability ?

Ajay Shriram: Well we are, we are looking at one project, it is called the Benfield project which actually reduces the energy consumption. This will be commissioned by December, and we have got other things on the drawing board based on this new policy government has brought out. We will invest to improve our energy efficiency so that we are viable. So we have plans for that.

Moderator: Thank you. Our next question is from the line of Rajiv Rastogi, individual investor. Please go ahead.

Rajiv Rastogi: Are we considering any special situation, like a scheme of arrangement whereby we separate various businesses to unlock shareholder value?

Ajay Shriram: No, we are not looking at any proposal like this.

Moderator: Thank you. Our next question is from the line of Aman Sonthalia from Suvridhi Capital. Please go ahead.

Aman Sonthalia: Sir, what was the realization of sugar in last quarter?

J.K. Jain: It was about Rs. 2,300/Qtl something.

Aman Sonthalia: And sir what is the breakeven cost of sugar if we take the sugarcane prices to Rs.250 per quintal?

Ajay Shriram: 250?

Aman Sonthalia: Yes, last year it was around Rs.253 most probably.

J.K. Jain: No, see last year the SAP was Rs.280 and government has given a subsidy of Rs.40, so we had a net price of Rs.240 and as we have indicated in our comments at that cane cost and the prevailing sugar price we had a negative margin of over Rs.500.

Aman Sonthalia: So the costing is around?

J.K. Jain: The costing comes to around 3,050, the price was about 2,550.

Aman Sonthalia: And how do you foresee the coming season of sugar, because right now the government has indicated, they have notified that you have to export and if this 30, 40 lakh tons goes out of the country then how do you see the future of the sugar industry?

Ajit Shriram: I think the future of the sugar industry seems positive, taking into account this export policy which the central government has announced and we are really hopeful that from the coastal states raw sugar is exported in the next few months, so that would help reduce the sugar stocks within the country as well as improve the domestic prices. But the policy is uncertain as to how much subsidy will be given to the sugarcane farmers at the moment.

Aman Sonthalia: And do you have any idea what will be this coming season cane price?

Ajay Shriram: It is very difficult to say at the moment, discussions are on with the state government but nothing has fructified yet.

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

Dheeresh Pathak: Can you just briefly explain the new urea policy, how it impacts us because of higher gas price and reduced energy norms, what is the net impact and briefly just explain the new urea policy.

Ajay Shriram: See, what the government has done is that they have clubbed all the plants into various groups depending on their energy consumption, vintage of the plant etc, etc. And they have made 4-5 groups under which they have identified what should be the energy consumption norms for various groups of plants. In our case, the energy norm was about 7.7-7.8, which has now come down to 7.58 and by 2019 it will be brought down to 6.5. So based on that we are working on how to improve our energy efficiency norms so that our consumption is down.

Dheeresh Pathak: So this 7.5 is the normative norm, what is our actual consumption?

J.K. Jain: Actual is about 7.25 today.

Dheeresh Pathak: So earlier the difference was 0.6, now the difference is only 0.25, so it is negative for us?

Ajay Shriram: Yes, so that is one. See, another factor in our case is, because we used 35% of our energy from coal and not only from gas, so our per 1000 kilocalorie cost of coal is actually lower than what it is for gas energy, but in terms of numerical numbers it is higher. So we have taken up this issue with the central government saying you please appreciate that if we were to convert to 100% gas then our numerical number of energy consumption will come down but our cost will go up because the gas price is more than double the price of our coal cost. So this is another discussion we are having with the central government and the department of fertilizers. But anyhow, we are moving for reducing our energy consumption through various norms, it will require some CAPEX which we are discussing and which we will take up to the Board whenever required to bring it down to 6.5 by the year end 2018. So that is the direction we are taking.

Dheeresh Pathak: And how has the pooling impacted us?

Ajay Shriram: Pooling has had a bit of a negative impact in the sense that earlier on our delivered price was about $7.8/unit of gas, now it has gone up to about 10 plus. This has led to higher subsidy outstandings and hence higher requirement for working capital.

Dheeresh Pathak: So this $10/unit is on the paper, the pooling because actual physical pooling is not happening, so 7.8 would be your actual cost but the difference are you paying to some agency.

Ajay Shriram: No, see the billing is all being done through GAIL and they are wanting the billing to be done on the pooled price basis. So our outstanding will be on the pooled price basis.

Dheeresh Pathak: So to that extent your subsidy receivables are going up, okay.

Ajay Shriram: Correct, because there is a delay in reimbursement from the government.

Dheeresh Pathak: And one more thing was, how are you impacted by this royalty issue that has happened in India on BT Cotton and what is the status right now, are you part of that or if you are not part of that why you are not part of that litigation?

J.K. Jain: See we are following the contract that we have with Monsanto and staying as per the contract. Having said that, commercially we understand that, I mean you also know that the industry is going though strain with farming cost going up and Government's like Maharashtra reducing the prices. So there are commercial discussions happening with Monsanto as to how does one share this situation, but that is happening simultaneously we are not saying that we can unilaterally revoke the contract and stop the transactions, that is not the approach we are taking, we are continuing to follow the contract and simultaneously discuss with them and arrive at an amicable solution.

Dheeresh Pathak: So you have paid whatever was due.

J.K. Jain: We have paid, as per the contract whatever is due.

Dheeresh Pathak: And last question sir, can you explain this power cost increase at the Kota complex post budgetary changes, can you explain that impact?

Ajay Shriram: Couple of things have happened, on the coal that we get from Coal India which is for our Kota plant, there has been two cesses which have been put in over the last one year.

Ajay Shriram: There was a green cess of Rs.100 per ton which was put in the central budget and then the State of Rajasthan has imposed electricity duty of Rs.0.40 per kwh and then urban and water cess of Rs.0.25 per kwh.

Ajay Shriram: On captive generation of power.

Ajay Shriram: So therefore our power cost has gone up by Rs.0.65 per kwh just because of these duties besides the Rs.100 green cess on coal.

Dheeresh Pathak: DO you have linkage with Coal India?

J.K. Jain: Yes, we have a linkage with Coal India.

Dheeresh Pathak: So now when they are planning to auction then we will have to bid in the auction, how will it work?

J.K. Jain: Yes, depending upon whatever policy they develop for the linkages going forward we will have to follow that policy.

Dheeresh Pathak: So your current at the gate price is how much per ton from Coal India including the cess?

J.K. Jain: We measure it in terms of paisa per 1000 kilocalorie which is roughly about Rs.1.

Ajay Shriram: But I will just add, simultaneously what we are doing after this increase at our Kota complex on our capital generation that we are now very actively buying off the power exchange on a regular basis, so we buy between I would say 5-7 megawatt and 25 megawatts off the exchange whenever we can, when we feel we can get a better price and what is our own cost of production.

Dheeresh Pathak: So the difference is not much, your own captive production cost and buying from the grid is not much right now is what you are saying?

Ajay Shriram: Well, I think the only impact has come in because of these additional cesses which have now come in, so that is a negative so we will look at it, whenever it will get cheaper we will buy off the exchange.

Dheeresh Pathak: Understood. And last if I can squeeze one more, what is the cash cost of PVC right now?

J. K. Jain: We have a PBDIT of about Rs.6,000 to Rs.7,000 per ton, so cash cost is about 57,000 - 58,000.

Dheeresh Pathak: Alright, your main cost here is power and coal and limestone, right?

J.K. Jain: Power and charcoal. Carbon material, let's put it that way, the sources are same but carbon material.

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

Satish Mishra: Sir, just to understand the Chlor-Alkali dynamics, is there any further capacity being added by other players or how you see the demand-supply situation in the Chlor-Alkali market in India?

J. K. Jain: See, recently last year there was a big plant which was commissioned by Aditya Birla Group, there are small additions happening but there is no major addition happening in last one year. The other thing is the demand of the product is growing anywhere between 4-5% per year and there are imports happening right now, India is a net importer right now of caustic, so therefore adding this plant does not affect dramatically the demand and supply situation. Also, I think the prices of these products are driven by the landed cost of imports, so it is the global demand supply and price situation which are major determinant rather than the domestic demand supply.

Satish Mishra: Sir just to understand again on this, in your annual report it is written that our total domestic capacity is 3.5 million ton whereas demand is 3.2 million ton but you are saying we are net importer, so if you can just close this…

J. K. Jain: See we are net importer because generally in this industry capacity utilization is between 75% to 80%, and there are some capacities which exist on paper but are not operating, so our production is much less than what is stated as capacity.

Satish Mishra: So sir how much will be total import out of this 3.2?

J. K. Jain: I think about 300,000 to 400,000 tons import per year right now.

Satish Mishra: And mainly it is from which countries?

J. K. Jain: It happens form Iran which is one of the major exporter and then other Southeast Asian countries.

Satish Mishra: Do we have any protection also or our price are completely aligned with the international prices?

J. K. Jain: We have protection to the extent of duties.

Moderator: Thank you. Our next question is from the line of Vaibhav Dhall from Kotak Mahindra Bank. Please go ahead.

Vaibhav Dhall: Sir I again want to take you back to this urea policy, just one small clarification. You talked about the energy efficiency norms and your consumption vis-à-vis the standard of around 7.5 kilocalorie. Now is there any incentive also which you are getting as part of meeting this target currently which will stop if you are not able to meet the revised 6.5 target?

Ajay Shriram: No, government is not giving any incentive, they have just worked out a number which they had come to. I would say the only incentive which is there is that the fixed costs of urea plants had not been revised from 2002-03, so we had a discussion in the last couple of years with the government and they agreed to give Rs.350 per ton to all plants to meet the rising fixed cost and to old plants like ours which are vintage plants, they agreed on additional Rs.150 per ton as sort of cost where for renovation and upgradation of technology they would give. But unfortunately this amount of Rs.350+150 to us and Rs.350 to 80% of the industry government has not yet given, that is pending for over a year now. So that is the only Rs.150 per ton is the only additional which was agreed year, year and a half back, but for this energy norm level there is no incentive at all.

Vaibhav Dhall: So coming back to this basic thing of the new urea policy by which I think the government is targeting to save some subsidy outgo, I mean the figure quoted is around 1,500 crores, if the gas pooling is subsidy neutral to some extent, it is just that subsidy for you is increasing and for others it is going down. Cumulatively where is the government saving on the subsidy then?

Ajay Shriram: I think they are just calculating on the energy side, they are looking at energy side and I think the reason why they have done this pooling is because then they can come to a common energy consumption norm at a common gas price with everyone, so the calculations are much easier. But the reality is, if anyone puts up a new plant and you do that on spot gas or natural gas that is about $14, $15, $16 per ton, you might level it out by pooling but the reality is that a new plant is going to get that additional gas at $14, $15. So I think that is really the position of showing a pooled price which is not the reality in terms of the actual cost or production of a new plant.

Vaibhav Dhall: So on the energy side you are saying this Rs.500 or whatever Rs.150 for you guys, that will be the saving for the government FY19 onwards because they would not be giving this?

Ajay Shriram: No, no that is something which is applicable which will become a permanent inflow to all companies which they have agreed to compensate the fixed cost from 2002-03 onwards which are not being increased.

J.K. Jain: The reduction in energy consumption norms will help the government in saving subsidy.

Ajay Shriram: Correct, not the fixed cost increase.

Moderator: Thank you. As there are no further questions I would now like to hand over the floor back to the management for their closing comments. Over to you, sir.

Ajay Shriram: Thank you. Thank you ladies and gentlemen. As we mentioned, the environment over the last couple of year has been characterized by high volatility in commodity prices and erratic weather conditions. This requires businesses to continuously work to become globally competitive and inherently strong. To enable this, we have intensified our efforts in terms of increasing our investment, in optimising our cost structures. In agri businesses, we are working towards improving our product portfolio as well as increasing our engagements with the farmers. These efforts would enable us to build in our competencies of cost leadership in commodity businesses and further build on our strong brand, broad product portfolio and distribution network in our agri businesses. Our strong balance sheet, reasonable cash flows and management focus will enable us to execute our investment program as per schedule. Once again, a Happy Diwali to all of you and your families. Thank you very much for joining us on our concall. Goodbye.

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