



DCM Shriram Consolidated Limited

Q3 & 9M FY2011 – Earnings Conference Call Transcript

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Moderator: Ladies and gentlemen good day and welcome to the DCM Shriram Consolidated Q3 and 9M FY11 earnings conference call. As a reminder for the duration of this conference, all participant lines are in the listen only mode, and there will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during this conference call, please signal an operator by pressing * and then 0 on your touch tone telephone. Please note that this conference is being recorded. I would like to hand the conference over to Mr. Ishan Selarka of Citigate Dewe Rogerson. Thank you and over to you Mr. Selarka.

Ishan Selarka: Good afternoon everyone. Welcome and thank you for joining us on DSCL's Q3 and 9M FY11 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. Rajiv Sinha, Deputy Managing Director, Mr. Ajit Shriram Director Sugar and Mr. J.K. Jain, CFO of the Company. Please note that some of the statements made in this conference call may be forward-looking and a note to that effect was sent out to you earlier. We will begin this conference call with opening remarks from Mr. Ajay Shriram and Mr. Vikram Shriram, following which we will have an interactive question-and-answer session. I would now like to invite Mr. Ajay Shriram to give us the brief overview on the Company's operations during the quarter and the opportunities going forward. Over to you sir.

Ajay Shriram: Thank you Ishan. Good afternoon ladies and gentlemen and a very warm welcome to DCM Shriram Consolidated Limited, Q3 and 9M FY11 conference call. I would like to begin by sharing my perspectives on the Company's operational performance, following which Vikram will take you through the financial highlights of the Company for the third quarter and nine months ending December 31, 2010.

Our business especially Sugar, Chloro-Vinyl and Cement witnessed better performance in the current quarter over Q2 FY11, though all of them continued to perform at significantly lower levels than last year. The performance of the Farm Solutions and Bioseeds businesses continues to be better. We feel that worst is behind us, and we expect better results going forward with improving market conditions in most of our businesses.

In the Chloro-Vinyl business, we have swung back, to producing downstream products i.e. Chemicals, PVC Resins and Carbide as against merchant power sales till Q1 of the current year as the power rates

registered a sharp decline. However, the margins on the sale of down streams products are lower than the margins achieved from the power sales in the previous year. The business performance has also been impacted by the cost increases specially of coal and carbon materials. The cost of imported coal has gone up by almost 40% in the last two quarters. We expect to continue with downstream products for the next few quarters.

Moving to our Sugar business, the Company has sold all the high cost inventory of sugar season 09-10. The crushing in all our factories has progressed well, with cane crush till date about 10% higher than the last year. We expect that the country's sugar production should be in the range of 24 to 25 million tonnes. The international sugar prices have touched a 30-year high recently; however, this is clearly not yet reflected in the prices in the domestic markets. We believe that even if the government were not to allow exports, we would still have a tight year, which would keep the prices at the current levels and with the cane prices at ₹ 205 per quintal, the margins could remain positive for the remainder of the year vis-à-vis negative margins registered in the last sugar season.

The Fertilizer business on the other hand has reported a satisfactory performance on account of higher volumes as compared to previous year. The delay in finalization of the new urea policy by the government is affecting the industry adversely, due to non-compensation of cost increases. We hope, the policy is announced within FY11, so that this business keeps generating stable cash flows.

In the Farm Solutions business', with the reintroduction of DAP and MOP in the portfolio the performance has been augmented. Also aiding performance was the volume growth in SSP, pesticides and other value-added products. We are making further efforts to strengthen our Agri-extension activities with a view to deliver better solutions to the farmer. We believe that this business will continue to be on the growth path in the coming quarters on the back of demand for quality Agri-solutions by the farming community.

Our Bioseed business registered a healthy growth in top line led by a healthy performance by vegetable seeds business in India and paddy in Vietnam. The Company is witnessing a strong demand across its hybrid seeds portfolio. We believe that strong R&D, Agri-extension work with farmers and the brand are our key strengths of this operation. We are confident of accelerating the growth further with the strong product pipeline and the expansions to new territories. This business has seasonality with high turnover and profits being realized in the first and the fourth quarter.

Regarding Hariyali, we shared with you in the earlier conference calls that the Company is strengthening all aspects of Hariyali's operations with the help of experts. We have implemented the plan, which involved micro segmentation of markets, focused price value proposition, product offerings in-line with these value propositions and a strong customer acquisition program, involving promotion, and several other initiatives more closely. The initial results of these efforts are good with core retail sales going up by approximately 30% in December 2010 - January 2011. We are hopeful for improved performance in this business going forward.

Fenesta continues to register strong order booking growth across projects and the retail segments. The actual execution and the installation is slow in the projects segment due to the slowdown in real estate projects leading to slower turnover growth. We expect the retail segment to grow faster which will help us in registering good growth in this business in coming years.

Overall, we expect better performance going forward on the back of expected positive margins in the sugar business; improved margins in Chloro-Vinyl business post the change in strategy to move to downstream products, continuing growth trend in the Agri-inputs vertical and better performance in Hariyali and Fenesta.

I will now request Vikram to take you through the financial figures for Q3 and 9M FY2011.

Vikram Shriram: Thank you. Good afternoon ladies and gentlemen. I will now summarize the financial results for the third quarter and nine months ended December 31, 2010.

Total revenues for the quarter were higher by 14% at ₹ 977 crore compared to ₹ 854 crore on account of improved contribution from the Farm Solutions and Bioseeds businesses. For the nine-month period revenues were higher by 15% at ₹ 3,045 crore. PBIT for the quarter, stood at ₹ 4 crore while for the nine-months it was at negative ₹ 17 crore. The subdued PBIT was largely a result of lower margins in the sugar business, lower net back in the Chloro-Vinyl businesses apart from increasing costs of coal and carbon materials, and dip in the cement businesses PBIT, primarily due to reduction in sales realizations. The interest costs for the quarter and the nine-months were lower by 23% and 33% at ₹ 14 crore and ₹ 47 crore respectively. The reduction in interest cost during the quarter is a reflection of substitution of the rupee borrowing by FOREX borrowing. The debt outstanding as on December 31, 2010 was ₹ 1,496 crore.

We will continue to conserve cash. However, increase in interest rates and some sugar related borrowing, may impact financial charges in the short term.

Net Loss for the quarter and the nine-months stood at ₹ 4 crore and ₹.43 crore respectively. Let me now take you through our business wise performance for the quarter under review.

The Fertilizer business continued to have a stable performance with PBIT for the nine months FY11, being ₹ 30 crore as against last year's ₹ 29 crore.

Farm Solutions business revenues were higher during the quarter and nine months by 113% and 124% at ₹ 180 crore and ₹ 768 crore. The revenues were higher during the quarter due to sale of DAP which was nil last year, along with higher sales of SSP, pesticides and value-added inputs. PBIT for the quarter and nine months improved by 75% and 109% at ₹ 6.4 crore and ₹ 32 crore, due to high volume growth in value-added inputs.

The seasonal nature of the seeds business resulted in negative PBIT of ₹ 6.6 crore from the Bioseeds operations during the quarter. However, for the nine-months, revenues and PBIT were higher by 44% and

107% respectively, at ₹ 178 crore and ₹ 15 crore, led by a healthy performance across all geographies, and strong demand across hybrids. Just to reiterate the performance of this quarter is not indicative of the full year's results.

Revenues during the quarter from the sugar business were lower at ₹ 121 crore on account of lower free sales sugar volumes and lower realizations of sugar and by-products. The PBIT declined during the quarter to ₹ 16 crore against last year of ₹ 36.9 crore as the margins swung from ₹ 731 per quintal in Q3 FY10, to a negative margin of ₹ 283 per quintal. For the nine-month period revenues were at ₹ 375 while PBIT swung from ₹ 55 crore in the previous year to a loss of ₹ 40 crore in the current period, due to margins swings and lower free sales sugar volumes.

In Hariyali Kisaan Bazaar revenue increased to ₹ 563 crore as against last year of ₹ 472 crore during the nine months period. This growth is primarily attributed to high growth in fuel and seed categories. The core retail sales grew by about 5% during the quarter, despite a 10% reduction in the number of outlets. The Company incurred one-time cost of about ₹ 10 crore in the first half of the year on account of one-time rationalization and consultants cost which have resulted in lower PBIT.

The Chloro-Vinyl business revenues during the quarter were higher by 21% at ₹ 220 crore due to higher sales of downstream products as against power sales in the previous year. The PBIT declined to ₹ 21 crore during the quarter as Company swung back to downstream products which were less remunerative as compared to power sales in the previous year. However, sequentially with full capacity utilization, it has resulted in an increase in revenue from ₹ 172 crore in Q2 FY11 to ₹ 220 crore this quarter and better PBIT i.e. from ₹ 9 crore in Q2 FY11 to 21 crore in Q3 FY11.

Revenues and PBIT of Cement businesses declined during the quarter and nine-months essentially due to decline in realizations.

Revenues under other segments during the quarter and nine months stood at ₹ 81 crore and ₹ 260 crore respectively. The revenue increase is primarily attributable to higher revenues from Fenesta business. The growth is however slower than planned due to slack in project execution in builder segment, which has resulted in an increase in negative PBIT.

These on the broad level are our financial numbers. We glad to take any question that you may have.

Moderator: Thank you very much sir. We will now begin his question-and-answer session. Our first question is from the line of Falguni Datta of Jet Age Securities. Please go ahead.

Falguni Datta: You just mentioned that you have seen a 30% growth in the core retail sales in HKB. So what would this essentially comprise and secondly have there been margin improvements here.

Ajay Shriram: On the Hariyali front, the increase in turnover is because of our fuel and seeds businesses that have moved well.

J.K. Jain: Core retail comprises of four vertical, which is Agri related product, inputs that goes in farming, food and grocery, household and lifestyle. This sale has gone up by 30% vis-à-vis last year.

Falguni Datta: Can you could give me an absolute figure for core retail in the last year.

J.K. Jain: We would not have the category wise number readily available. However, the total Hariyali turnover the number is available with you in this segment.

Falguni Datta: So when you say 30% growth in the core retail sales; is it Y-o-Y or Q-o-Q?

J.K. Jain: It is on a month-to-month basis.

Falguni Datta: It is 30% of the core retail and not essentially 30% of the entire sales of HKB.

J.K. Jain: The HKB sales comprise of the core retail, fuel, trading and seeds. These are the four verticals. Core retail contributes to about 40% to total sales of HKB and that has gone up by 30%.

Falguni Datta: Have the margins also improved. In addition, when would we see substantial reduction in losses in this segment?

Ajay Shriram: Let me put it this way, the substantial improvement in the margins is not the issue. The issue really is; how do we increase our sales, so that the margin that we are getting is on a larger base. In addition, as we mentioned a little earlier that despite closing 10% of our outlets, our sales are going up. Our focus really is how to provide a better offering, how do we increase footfall, and increasing transaction value. I think there has been an improvement, which is encouraging. Regarding break-even, as we said in the past it would take a couple of years and it's not something that can happen rapidly.

Falguni Datta: I understand that break-even would take some time, but when could we see a significant reduction in losses.

Ajay Shriram: Based on our business plan and on the improvements that we have made, we think after two or three quarters there should be an improvement, which will be distinctly visible.

Falguni Datta: How do we as analysts estimate the numbers for Bioseeds business?

Rajiv Sinha: The Bioseeds business, as you said and as our Chairman said, is essentially like many other Agri businesses. It is a business, which has seasonal variation. Therefore, bulk of the sale takes place say around Kharif and it will take place around Rabi. Essentially, it covers the first two quarters of the financial year, the third quarter there is practically no sales except some sales of vegetable seeds, etc. In the fourth

quarter, the sales pick up again. Broadly speaking, we are also operating in Philippines and Vietnam; in both these countries, also the third quarter is a quarter, in which the sales are relatively lower, except for paddy in Vietnam. Therefore, we will always see a situation that the revenues in the third quarter are relatively small and therefore we tend to see a negative profitability. However, if you see the third-quarter numbers for FY2010 versus FY2011, the loss is lower. This process will continue and as we go into more territories and more crops, hopefully this effect will start getting less and less impactful.

Falguni Datta: How much do we need to spend on research in this segment?

Rajiv Sinha: It is between 10 to 12% of our revenues.

Falguni Datta: Have we seen an improvement in ECUs because I was just looking at some data source, which shows that caustic soda prices have improved significantly. Just wanted to confirm if they are better compared to what they were in Q3?

J.K. Jain: On a month-to-month basis the prices did go up. December prices were about ₹ 2,000 higher than September prices. This is on a month basis and not quarter basis. Nevertheless, we had noticed some softness off late in the late last week of January and February. So, whether it is sustainable or not is what we are not very sure about.

Falguni Datta: What are they currently like?

J.K. Jain: It is about ₹ 18,000 to ₹ 18,500 for the western zone.

Ajay Shriram: Western zone is about ₹ 18,000 – ₹ 18,500 and the northern zone has a little higher, it has traditionally been approximately ₹ 2,000 higher.

Moderator: Thank you our next question is from the line of Ajit Dange from SBI Mutual fund. Please go ahead.

Ajit Dange: I understand that Q3 may be a weak quarter for power sales as the merchant power may not be remunerative. However Q4 particularly and Q1 of next year is likely to be better for power sales, being summer month. So, what would be the game plan? Would you prefer to switch again to merchant power sales in these quarters or you will continue with downstream production?

Ajay Shriram: As we have done in the past, our objective always is optimizing the earnings for the Company. I think what we have to do a little more on the judgment basis is what percentage of production do we back down to sell power, depending on what is the Delta or the difference between the per unit net back on power from our products vis-à-vis from sales of power in the market. For instance, in the last couple of days we sold some surplus power in the market, which has been in the range of ₹ 4.95 per unit. Therefore, we are perpetually open and aware that we must optimize and capitalize on any situation that

arises and based on that we will likely sell power down the line, depending on what is the realization in the marketplace.

Ajit Dange: Is there any downtime particularly wherein you decide to switch from downstream production to power or is it instantaneous?

Ajay Shriram: It is actually instantaneous. We have to just back down power in our Chlor-Alkali plant or Carbide furnaces and we have the power available for sale. But balancing it correctly is important so that we have a presence in the market as if you back out to the market then you have to come back into the market with your product. Therefore, that is why we have to be a little bit cautious of not moving in extremes.

Ajit Dange: Given that ₹ 205 is the price to be paid for sugarcane; what kind of EBIT margins would you be looking at for next year, currently I believe the realizations would be in the range of ₹ 28-28.5 per kg?

Ajay Shriram: Correct, I think it will be improvement over the last quarter, that is definitely there and over the last year, it is going to be a better performance than what we have.

J.K. Jain: EBIT margins will depend on the price, which is a difficult to ascertain. However, our cost will be about ₹ 26 to ₹ 27 at EBIT level.

Moderator: Thank you Mr. Dange. Our next question is from the line of Mr. Rakesh Ravindran of CRISIL Research. Please go ahead.

Rakesh Ravindran: What percentage of your feedstock in the Fertilizer business is coming through the naphtha route?

Ajay Shriram: It is 100% now on gas.

Rakesh Ravindran: So in that case is it 100% on RIL gas or some LNG as well?

Ajay Shriram: It is all RIL gas. It is an agreement that we have for a 5 year period.

Rakesh Ravindran: So the LNG business does not affect you.

Ajay Shriram: No, it is a fixed price contract.

Rakesh Ravindran: What is your view on the expected deregulation in urea?

Ajay Shriram: One is that deregulation has been a bit of a political turmoil for some time, and this morning the Mint daily had another letter, which was sent by our Fertilizer Minister saying, that it should move on the NPS-IV policy and not the nutrient based scheme (NBS). Bit of a confusion, but I think frankly from the

industry point of view, the issue is that many costs which were incurred or which have arisen over the last 3-4 years, have not been reimbursed to us. Therefore, whether we move on the NPS-IV or the NBS scheme, I think there will be an advantage to the industry across the board. Therefore, our interest is whatever policy, if the government is uncertain please go ahead and bring in the new change NPS-IV policy and start that immediately and preferably from retrospective effect. The government had taken it up to implement it from 1st of October, 2010. So let us do it from then, start that activity and get it going. In the meantime sort out all the issues which have arisen or questions which keep coming up on the NBS policy, and bring it in after six months or one year or two years whenever the government wants, because the industry's approach is do not hold back, otherwise we are stuck.

Rakesh Ravindran: Any debottlenecking activity that you are taking up?

Ajay Shriram: We will not look into it until we know what the policy is. So I think once you get the NBS, and then we would look at things differently. NBS would be a good direction for the entire industry.

Rakesh Ravindran: It seems that the nutrient based subsidies seem a bit far-fetched as of now because even if the government were to implement that there will be lot of other tangles that the government would be tied up in. For example, there would be plants that are naphtha based whose cost of production would be much higher; hence, the government might have to give some kind of selective subsidy to them. Till the time everyone is on gas this policy would not see the light of the day?

Ajay Shriram: You are right. I think industry also suggested trying to find solutions so that we can move ahead with the progressive policy sooner than later. I think convergence of all the plants if one-take plants like NFL, Mangalore Fertilizers, Zuari, etc., they will take time because they do not have a gas pipeline.

Rakesh Ravindran: Exactly that would take 2 to 3 years.

Ajay Shriram: Yes. One way is to bring about a change now. Study it more but do not wait for two - three years open-ended. Try to look at a change earlier and then adjust it to take care of whatever the situation is today, and then you modify that whenever everyone has converted to gas. So that is our approach, but let us see what happens. There is a COS meeting scheduled on Feb 7. So let us see what comes out of that.

Rajiv Sinha: As far as our own situation is concerned, we are okay both ways, be in a NBS situation and modified NPS situation.

Moderator: Thank you Mr. Ravindran. Our next question is from the line of Falguni Datta of Jet Age Securities. Please go ahead.

Falguni Datta: What would be the cost of power at current coal prices?

J.K. Jain: The direct cost would be about ₹ 4 per unit. This is based on imported coal at our Bharuch plant.

Rajiv Sinha: For Kota it would be Rs 2.90.

Falguni Datta: You have been advocating FDI in rural retail, what is the progress there?

Ajay Shriram: The government is saying that they are having consultative discussions. Whenever we have spoken to anyone or through our business associations whether it is CII or FICCI, people realize that, by organized retail, it will help the farmer because there is a direct link due to technology transfer, knowledge transfer and the supply chains becomes much sharper. All these things would benefit the farmer ultimately, and instead of having 7-8 different steps in middle between what they say farm to fork, that has come down to 3-4, with higher degree of technology. There is a certain degree of politics involved in this decision. On the face of it, people appreciate that there is value considering 65% of our population lives in rural India and why do we want to deprive them of the benefit of organized retail, where you have a fresher produce, better prices and a larger range at a better price and where the farmer ultimately gains. I think it is an issue, which is under discussion and debate.

Falguni Datta: In your opinion what is the likelihood of it happening?

Ajay Shriram: It is difficult to say as to what is likely to happen based on what people say they appreciate the value. Now I think the politics will take the view of what is going to be the outcome.

Moderator: Thank you Ms. Dutta. That appears to be the last question; I now hand over the conference over to the management for closing comments.

Ajay Shriram: Thank you very much, once again for joining us on the conference call. As mentioned during our discussions, we expect better performance during the forthcoming quarters, as our strategy in the Chloro-Vinyl business to increase downstream products should yield better margins. In the sugar business, we expect positive margins for the remainder of the year. The strong growth in our Agri inputs verticals and Fenesta is expected to continue. Lastly, Hariyali should also record better performance from the next financial year. Thank you once again. Goodbye.

Moderator: Thank you very much members of the management team and Mr. Selarka. Ladies and gentlemen, on behalf of DCM Shriram Consolidated that concludes this conference call. Thank you for joining us and you may now disconnect your lines.

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