

Transcript of Tata Chemicals Q2 FY2004 Conference Call

Moderator: Good evening ladies and gentlemen. I am Monali the moderator for this conference. Welcome to the Tata Chemicals conference call hosted by SSKI Securities. Mr. Chirag Shah of SSKI is your call leader today. For the duration of the presentation, all participants' lines will be in the listen-only mode. After the presentation, the question-answer session will be conducted for international participants connected to SingTel. After that, the question-answer session will be conducted for participants in India. I would like to hand over to Mr. Chirag Shah of SSKI. Thank you and over to Mr. Shah.

Chirag Shah: Good evening everybody. It gives me great pleasure to invite you all to the Tata Chemicals second quarter conference call. I have with me Mr. Prasad Menon and Mr. P.K. Ghose of Tata Chemicals. I would like to hand over the call to Mr. Ghose who will give us a brief perspective on the second quarter results, and then Mr. Menon can take it forward, to give us a brief idea on the strategy of the company going forward.

P.K. Ghose: Thank you Chirag and good evening everyone. On behalf of Tata Chemicals, I welcome you to this conference call. I will take this opportunity to share with you some perspectives on our financial performance. Following this, Mr. Menon will share with you some key insight across our businesses, after which we will be happy to answer your queries.

Tata Chemicals' performance in the just concluded financial quarter has been characterized by encouraging topline growth and strong PAT enhancement. Income from operations was higher by 16% at Rs. 483 crore. This comprised revenues of Rs. 264 crore from our fertilizer business segment - an appreciation of 29%, and Rs. 219 crore from our inorganic chemicals business segment. Improved efficiencies and enhanced realizations have seen EBIDTA improve 11% to Rs. 139 crore delivering an EBIDTA margin of 29%. The company's PAT has appreciated 71% over PAT in the corresponding period last year translating to a non-annualized EPS of Rs. 4.46.

Let me also briefly touch upon the company's performance from a half yearly perspective.

Income from operations grew 6% to Rs. 791 crore. Both the fertilizer and the inorganic chemicals businesses performed creditably demonstrating 7% and 6% growth respectively. EBIDTA demonstrated a healthy 13% rise, reflected in the 32% operating margin. While improved realizations from the fertilizer business played a part, I must highlight the continuing contribution of our efficiency program Project Manthan, which delivered savings of Rs. 40 crore, 20 each in Q1 and Q2. PAT too grew impressively by 59% to Rs. 129 crore delivering an EPS for H1FY04 of Rs. 7.14.

I would also like to highlight the large quantum of income tax refunds received during Q2FY2004, which have contributed to significantly reducing the company's contingent liabilities. During the just completed six-month period, Tata Chemicals received tax refunds of Rs. 53 crore, but the cash refund received both for the current financial year and the previous financial year was around Rs. 118 crore.

Tata Chemicals adopts a two-pronged strategy towards efficient financial management. As a result of this strategy, total debt has declined 33% to Rs. 617 crore resulting in a debt equity ratio of 0.36 as compared to 0.56 at the same time last year. A large proportion of the company's outstanding debt has been repaid through internal cash generations.

Additionally, the weighted average cost of borrowing have reduced to 8.2% in Q2FY2004 as compared to 10.5% in Q2FY2003, and the net interest outgo contracted by 50% to Rs. 25 cores in H1FY2003.

I look forward to a continued healthy top line and bottom line growth second half of the current fiscal. I now request Mr. Menon to share with you some key initiatives and development across our businesses.

Prasad Menon: Good evening. It is a pleasure to be with you all on this conference. Let me share with you some of insights across our key businesses.

Our inorganic chemicals business has demonstrated encouraging growth. Tata Chemicals continues to be the leader in the soda ash segment with a market share of 34.3%. Over the last six months, we have aggressively explored new geographies and we have exported 81,000 MT of soda ash, over 75% of the total volume achieved in the last financial year. Besides expanding our customer base, this has contributed to improving our capacity utilization levels, which currently stands at about 87.4%. Increased construction activity has witnessed a sharp increase in demand for soda ash from glass manufacturers. Going forward, the flatglass segment is expected to grow at close to 10% - far greater than any of the other demand categories. Keeping this in mind, Tata Chemicals has significantly enhanced its focus on sales to glass manufacturers. The percentage of glass manufacturers in the total customer base has increased 18% over the corresponding period in the previous year. This segment presently constitutes about 23% of our total sale.

In edible salts too, the Tata Salt brand has strengthened its leadership position with a market share of 37.6%. The business also contributed Rs. 35 lakh throughout the 'Cause Related Marketing' initiative, which we call 'Desh Ko Arpan', which is dedicated towards educating underprivileged children.

In fertilizers; as you would noticed, the PBIT from our fertilizer business improved 42% on a corresponding quarter basis. This impressive performance is a result of the company rephasing its sales in line with market conditions and the agricultural season. The Group Pricing Policy, which was announced in April, would marginally impact Tata Chemicals'

performance in the near term, however, over the medium term, we believe it will encourage efficient manufacturers. Possessing the most efficient plant in the country, with energy utilization currently running at about 5.28 GCal per ton, I believe we are best positioned to benefit from the gradual changes in policy.

Going forward, I believe our core businesses are showing a strong performance upturn driven by internal efficiencies and initiatives, and supported by an increasingly conducive external environment.

We look forward to sustaining our performance going forward. Mr. Ghose and I would now be happy to discuss any subjects you have in mind.

Moderator: Thank you very much Sir. We will now begin the Q&A interactive session for participants connected to CyberBazaar, India. Participants who wish to ask questions, please press *1 on your touch-tone enabled telephone keypad. On pressing *1, participants will get a chance to present their questions on a first-in-line basis. To ask a question, please press *1 now.

We have the first question from Mr. Jaideep Goswami of HDFC Securities.

Jaideep Goswami: There are few things I would like to know. First, there is a news article saying that Tata Chemical is looking to buy new fertilizer capacity. What is your thinking, in view of your corresponding merger that is happening with Hindustan Lever Chemical now? And second, how do you see the pricing trend in soda ash category?

Prasad Menon: Certain changes have taken place in the environment, particularly with regard to urea over the last year. The major changes really are that the prices globally tended to firm up and we no longer have a situation of \$90 and \$100 prices for Urea. It has now gone up to about \$160 and we see it stabilizing between 140 and 150 over the next three to five years.

Secondly, in India after the Reliance gas find, the outlook on gas availability as a cheap stocking fuel for Urea fertilizer has considerably improved. If you combine the Reliance find along with the LNG proposals of Petronet as well as Shell, we will see a situation particularly on the gas pipeline on the HBJ where we should be able to have enough gas to look at the possibility of increasing capacity. What we are doing is, we are awaiting Government policy with regard to expansions - whether it is brownfield expansion or a 20-25% capacity increase through de-bottlenecking. Once that policy is announced, we will have to check whether that is an area forward for us. We are constantly looking at the possibility of going and examining possibilities of acquisitions outside the country where the gas is freely available. We do not have any particular target in mind, but we are open to looking at this.

As far as soda ash pricing is concerned, at the moment global prices are fairly firm and there is a small tendency in the United States market for a five to six dollar increase per ton. This is largely driven by the increases in energy prices in the United States. I would

say that in the next six to nine months, I do not see any major change in soda ash prices. If at all, it might harden by a couple of dollars.

Jaideep Goswami: One follow-up question, what is the current stage of the merger with Hindustan Lever Chemicals? What synergy are you going to derive from that?

Prasad Menon: The Mumbai High Court has cleared the proposal for the scheme for the merger, but the High Court in Chandigarh has still not cleared it. We believe it will probably come through only sometime later in November. The Government is still in the process of finalizing the DAP policy. We do believe that the Cabinet and the Department of Fertilizers will finalize this over the next month or so. We need to wait and see what kind of policy finally emerges.

As far as the HLCL merger is concerned, it will probably take effect from early next year and we will then have to see what we need to do to drive the synergies there.

Moderator: Thank you very much Sir. We have the next question from Mr. Amit Dalal of Amit Nalin Securities.

Amit Dalal: What is the character of the international market of soda ash? What markets do we service, and who are our customers in terms of industrial buyers?

Prasad Menon: We are currently servicing markets in Indonesia, in Thailand, in Bangladesh, and the Arabian Gulf. Most of the market in these areas is actually dense soda ash, which is required by glass manufacturers. As we have highlighted earlier, India has a skewed customer base for soda ash, we actually have about 40 odd percent of our customers in the detergent market whereas glass comprises only about 20-23%. But the situation globally is exactly the opposite; it is glass which takes up most of soda ash and detergent is probably only about 10-12%. So, most of the customers outside the country, except for Bangladesh, are glass manufacturers, where we have been supplying to major glass manufacturers in these areas.

Amit Dalal: Followup question to that, why has the demand for soda ash picked up in these markets, considering that the economic situation in these markets has almost remained the same for the last couple of years?

Prasad Menon: The infrastructure requirement, mainly driven by China, has gone up. The Chinese production and Chinese demand for soda ash has rocketed in the last couple of years. China, as you probably know, used to be the main exporters to these markets, and currently because of the huge demand in their own country, they have pegged their exports virtually at the same level that they had over the last two years. We saw an opportunity to get a foothold into these markets. It is not that these markets have themselves gone up considerably in the last two years - they have moved up, but it is really because China's own demand has gone up.

Amit Dalal: Couple of small questions. One, what is the relative realization for exports to the domestic soda ash prices? And second, is the debt equity ratio net of cash assets?

Prasad Menon: Export prices are about 15% lower...

Amit Dalal: And if I were to remove the cash assets, the debt equity would be?

P.K. Ghose: If you were to exclude short-term debts then it will be about 0.19:1

Amit Dalal: Okay. Thank you.

Moderator: Thank you very much sir. Next we have Mr. Vinit Sambre from IL&FS.

Vinit Sambre: Congratulations on good numbers. My question pertains to your soda ash business. When I see the PBIT reported levels of soda ash business, it has actually come down from around Rs 50 crore in Q2 of September to around 41 crore. Also, if I compare it with your Q1 numbers, it has gone down substantially. What is the main reason for this? Do you feel that just because the exports are higher, where the realizations are lower, there has been a decline in the PBIT levels?

Prasad Menon: Well, one of the major reasons is that the export prices of soda ash are lower than the domestic prices. There has also been a marginal difference because of the strengthening of the rupee as well.

Vinit Sambre: When I see Q1 numbers, the exports were substantially higher at around 45,000 tons. Q2, for the current year, it is 36,000 tons, which suggest that exports over Q1 have actually have come down. But PBIT levels have come down substantially from Q1 levels from 65 crore to 41 crore. What will you assign this particular fact to?

Prasad Menon: There was another issue that we had. We had certain sales tax benefits that ceased in the month of June. This has also brought down our net realization. We did a little bit of trading in soda ash as well.

Vinit Sambre: Trading, the profits are lower you mean to say?

Prasad Menon: That is right.

Vinit Sambre: So, trading was higher in the Q2.

Prasad Menon: We did that in a short period of time when we had some demand, which we could not meet from the current stocks. In June and in July, particularly, we had very very heavy unseasonal rain. The whole of Gujarat had very very heavy rains. Therefore, the plant capacity was not able to keep up with the demands that took place at that time. So, we did a little trading in soda ash as well.

Vinit Sambre: Do you feel the operations have streamlined now?

Prasad Menon: Yes.

Vinit Sambre: So, the margins will recover in the third and fourth quarter for the soda ash business?

Prasad Menon: They should recover a little bit. But as I said, that effect of the sales tax benefit being removed will continue now.

Vinit Sambre: Okay, would you quantify the benefits, which you had received in the quarter one?

Prasad Menon: The difference quarter on quarter would be somewhere around 4.5 to 5 crore

Vinit Sambre: Will not accrue to you in future?

Prasad Menon: Yes. That has gone now.

Vinit Sambre: My second question is regarding Hindustan Lever Chemicals. The performance for Hindustan Level Chemicals was very poor in the first quarter. As we understand, you also mentioned that there is a DAP policy which the Government is planning to come out with.

Prasad Menon: That is right.

Vinit Sambre: What I would like to understand is, how do you see the performance of Hindustan Lever Chemical moving ahead? And what is this DAP policy which is likely to come out?

Prasad Menon: The Government is in the process of finalizing this. Every three years, the Tariff Commissioner has a look at the entire industry and comes up with a policy for the next three years. This was done early this year around January-February and since then the Government has been looking at the recommendations. They also appointed an inter-ministerial group of secretaries to have a look at it, and they have had two or three revisions of this entire policy since then. This has still not been finalized. We understand that the final proposals from the Department of Fertilizers has gone to the Cabinet Committee, but we believe that this will take another two to three weeks before it is realized. In the meantime, we have to go on the basis of whatever earlier provisions had been given by the Government. Therefore, it is likely that you will see that the HLCL results for the first half is much much lower than last year. But we do see some improvement taking place in the second half.

Vinit Sambre: My next question is regarding your Manthan initiative, which you have taken. Rs. 40 crore is the saving which we have seen in the first half of the current year. What is the scope from here as to the savings, which you can actually bring in under Manthan Program?

Prasad Menon: We believe that we should get another 50 or 60 crore from the Manthan program, but you must understand that whatever saving we bring in is also getting eaten away by some other cost pressures that are taking place.

Vinit Sambre: We are seeing that power and fuel cost this time have increased substantially.

Prasad Menon: In fact this is going to be even more so over the next 6 months to 12 months.

Vinit Sambre: Okay.

Prasad Menon: Coal prices and coke prices globally have gone up and the other issue is that the shipping costs have increased.

Vinit Sambre: Yes, basically this 50-60 crore saving which you mentioned is on a yearly basis, or....?

Prasad Menon: Yearly.

Vinit Sambre: Okay. Thank you

Moderator: Thank you very much Sir. We have a question from Mr. Arun Kathiresan of Reliance Mutual Fund.

Arun Kathiresan: In terms of soda ash, where are we in the commodity cycle? Where do you see the soda ash price going from here in the next two or three years?

Prasad Menon: Well, I am reluctant to give you a forecast for the next two or three years, but certainly the soda ash cycle has gone up in the last one year and we should see this being sustained for another year at least. This has been following a tremendous dip that took place between the years of 1997 and 1999. So, I can even put my neck out and say that it will probably continue for another two years.

Arun Kathiresan: What have been the peak prices both in bottom and top?

Prasad Menon: The bottom prices went down to about \$80-85 and the peak prices. There are certain geographies where the price is about \$165 and certain other geographies like Asia where it is ranging at about \$125-130.

Arun Kathiresan: How do you see the demand-supply in India? Is there any plan to add capacity or acquire other capacities?

Prasad Menon: At the moment, we don't have any plans to acquire other capacities. We are watching the growth rate particularly in the flat glass industry, which is moving between 9 and 11%. This is linked to the tremendous boost in the infrastructure development, as well as in the automobile industry. Therefore we are putting up a dense soda ash plant which is costing us around 30-35 crore to take care of this increased demand from the float glass industry, both domestically as well as exports. We will be watching the situation over the next six to nine months and then determine whether we should marginally expand the capacity of our plant. We do have some plans to see whether we should increase the capacity from the current 875 to about a million.

Arun Kathiresan: What is the price difference between dense soda ash and the normal one?

Prasad Menon: Very marginal, but the customer base is very very distinct. The dense soda ash goes into glass and light ash into detergents.

Arun Kathiresan: Also, you talked about urea prices strengthening globally. Is there any actual import of urea in the last one or two years into India or is it just used as a protective mechanism?

Prasad Menon: There are very marginal imports between 100,000-200,000 tons.

Arun: Thank you.

Moderator: Thank you very much Sir. Next we have question from Mr. Ashwin Agrawal of Akash Ganga Investments.

Ashwin Agrawal: Can you comment on the Group Pricing Scheme on the fertilizer business in general? And how does it impact us as we fall under the post 1992 gas and our retention prices is lower than what we used to get, even in the phase II, there would be a proposed reduction in the CRC charges. How are we planning? And how is the situation?

Prasad Menon: As far as my comments on the Group Pricing are concerned, it is a step in the right direction, because we do see the industry gradually being decontrolled. While the final decontrol decision is really a political decision, it is moving towards a more, shall I say, transparent mechanism of subsidy payment. That is a good move.

As far as the Group Pricing effect on Tata Chemicals is concerned, there is a small knock. It is about 12-15 crore annually. We do believe that because of our better energy efficiencies, we should make up part of that. And the other thing that we will be doing is, as we ramp up our volumes through the Tata Kisan Kendras, we should get some benefit

there as well. All in all, we should be able to match up to the Group Pricing requirements.

Ashwin Agrawal: And on the CRC front?

Prasad Menon: On the CRC front, there will be a small drop next year, about Rs. 170. We will have to take some measures on reducing our fixed costs to offset that Rs. 170, we are confident of doing that.

Ashwin Agrawal: How do you feel about this phased decontrol, which is proposed from the Phase II, you know, that is Stage II? And how would you be pricing your products?

Prasad Menon: Well, again a good move. I am not sure whether they are going to remove it altogether, but they will probably continue to keep 25% under ECA. As far as we are concerned, we are certainly not going to contract our markets and move closer to the plant, we see that we do have a good market and a good premium in a state like Punjab and Uttaranchal, but we should certainly make sure that our Tata Kisan Kendras, which are really our drivers for these, are kept fully supplied.

We have already increased our numbers of franchisee Tata Kisan Kendras from about 250 to about 288, and we will continue to increase those numbers.

Moderator: Thank you very much Sir. We have a followup question from Mr. Vinit Sambre of IL&FS.

Vinit Sambre: My question pertains to the salt business. Would you like to give us the breakup of your revenues from the salt business and how much has it actually contributed to your EBIDTA?

Prasad Menon: The turnover of our salt business is roughly about 215 crore.

Vinit Sambre: This is for the full year?

Prasad Menon: That is for the full year.

Vinit Sambre: Okay, this quarter?

Prasad Menon: Quarter will be about 45-47 crore.

Vinit Sambre: In terms of contribution to your EBIDTA, what would be the contribution from your salt business?

Prasad Menon: We would continue to keep that as an overall contribution under inorganic chemicals since we have segmented it in that fashion.

Vinit Sambre: Coming back to your soda ash business, you mentioned that the glass industry you see a growth of around 8-11%, but the other segment where the soda ash is used, which is detergents, what kind of growth do you perceive in this segment going ahead?

Prasad Menon: Somewhere between three and four.

Vinit Sambre: Okay, and as far as the urea business is concerned, this cap was levied on the Urea manufacturers since first of April 2002. Is that cap still there?

Prasad Menon: On the production capacity?

Vinit Sambre: Yes.

Prasad Menon: That cap is still there but they have also come out with a scheme whereby if the Government needs more urea, rather than import it, they will ask the Indian manufacturers to supply and there is a particular formula that they have worked out where the contribution sharing will be done in the proportion of 65% to the Government and 35% to the industry.

Vinit Sambre: Has the demand has gone up for urea?

Prasad Menon: Yes.

Vinit Sambre: Has the Government actually approached the companies asking them to increase the production levels?

Prasad Menon: Yes, they have. They have offered to lift that cap.

Vinit Sambre: Okay. Thanks.

Moderator: Thank you very much Sir. Next is again a followup question from Mr. Ashwin Agrawal of Akash Ganga Investments.

Ashwin Agrawal: This is a general question. I understand our plant is on the HBJ gas pipeline, but say what happens if a company, in the second post 1992 gas-based units in that cluster, is not based on the HBJ network, the cost of gas would be higher. How would Government compensate these companies?

Prasad Menon: Which is the plant post 1992 that is not on the HBJ pipeline?

Ashwin Agrawal: I was referring to Indo-Gulf, pre 1992

Prasad Menon: The Group Pricing very clearly lays down a certain policy with regard to escalation on price of raw materials.

Ashwin Agrawal: Okay.

Prasad Menon: So, that will be covered by the Government.

Moderator: Thank you very much Sir. Next comes a question from Mr. Deven Sangoi of Birla SunLife.

Deven Sangoi: Congratulation on a very good result. I would like to understand what is the sustainability of this profitability in fertilizer business? Also, you mentioned about urea prices are firming up, how do you think the Government will put the subsidy bill on urea so that Tata Chemicals does not get impacted.

Prasad Menon: The first half is better than the second half.

Production in the first half is higher, and therefore in the second half we will be producing lower quantity, due to the cap on production. Therefore the margins from the urea business in the second half will not be as good as the first half.

Deven Sangoi: Okay.

Prasad Menon: This is entirely as per plan. The other question you asked about the urea prices, even though urea prices have firmed up globally, it will not affect the subsidy scheme for Indian industry at all.

Deven Sangoi: Okay.

Prasad Menon: In fact, as I mentioned earlier to another question, the Government has now offered to remove the cap on production, but it has come at a rather late date, so not many companies can take advantage of it. That is the issue. But obviously the Government is seeing the increase in prices of imported urea and certainly by next year, they will try and take advantage of local production, which is lower.

Deven Sangoi: Will it improve your margins in the Urea business?

Prasad Menon: Yes it will.

Deven Sangoi: Since the licenses are there next year, you don't see any adverse pricing policy for urea?

Prasad Menon: No, I don't see any adverse pricing policy, I don't see them in anyway moving in with further reforms.

Moderator: Thank you very much Sir. Participant show wish to ask questions, please press *1 now. The next is a followup question from Mr. Jaideep Goswami of HDFC Securities.

Jaideep Goswami: Is your current acquisition plan for new fertilizer entities more of a directional situation or are you seriously considering some of the properties in view of the fact that you have withdrawn from NFL?

Prasad Menon: It is a directional policy based on opportunities that might come up.

Moderator: Thank you very much Sir. The next is a followup question from Mr. Amit Dalal of Amit Nalin Securities.

Amit Dalal: We had a buy back resolution earlier, which had a price of Rs. 60, but considering that we have not gone for buy back earlier and we are in a business where the return of net worth is constrained by Government regulation. Would you consider giving a higher dividend payout at some point of time?

Prasad Menon: Right now, the only answer I can give you is, no, we have not considered any such thing.

Moderator: Thank you very much Sir. Next we have a question from Mr. Bharat Shah of ASK Raymond.

Bharat Shah: My question was about the cash flow during the first half. If you can give me the highlights of the cash flow was generated, before working capital and after working capital.

P.K. Ghose : The cash flow from operating activities was around 282 crore as compared to around 200 crore last year, but this was driven not only by great efficiencies in working capital management, but also a substantial amount even, from as I mentioned during my brief talk earlier, from cash income tax refunds.

Bharat Shah: I am sorry I missed the earlier part. Rs.282 crore is after working capital?

P.K. Ghose: No, Rs.282 crore will be net cash inflow from operating activities.

Bharat Shah: After taking into account working capital needs, what has been the capex?

P.K. Ghose: Capex plan is around 60 crore for the year.

Bharat Shah: For the current year?

P.K. Ghose : For the current year.

Bharat Shah: In the next year?

P.K. Ghose: Next year, we have not firmed our plan yet, but it will be somewhere between Rs 50 and 100. crore.

Bharat Shah: In terms of the cash flow for the coming next half, you expect somewhere in the similar region behavior?

P.K. Ghose: Income tax refunds will not be of the same level.

Bharat Shah: Yes, of course.

P.K. Ghose: Hence, the cash flow will be much lower.

Bharat Shah: No, I am saying net, after removing the income tax refunds, pure business cash flow, do you expect the second half to mirror the same thing? Similar trend?

P.K. Ghose: It would be in a similar kind of trend.

Moderator: Thank you very much Sir. Participants who wish to ask questions, please press *1 now. At this moment, there are no further questions from participants. I would like to hand over the floor back to Mr. Chirag Shah for final remarks.

Chirag Shah: If there are no further questions, I would like to conclude the conference call. I would like to thank everybody for attending the conference call, and particularly Mr. Menon and Mr. Ghose for being on the call.

Prasad Menon: Thank you very much.

P.K. Ghose: Thank you.

Moderator: Ladies and Gentlemen, thank you for using CyberBazaar's conferencing service. That concludes this conference call. Thank you for your participation. You may now disconnect your lines. Thank you and have a nice day.