Tata Chemicals Limited

Q3 & 9M FY17 Earnings Conference Call Transcript
February 08, 2017

Moderator

Ladies and gentlemen, good day and welcome to the Tata Chemicals Limited Q3 & 9M FY17 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. I would now like to hand the conference over to Mr. Gavin Desa from CDR India. Thank you and over to you, sir.

Gavin Desa

Thank you. Good day, everyone, and welcome to the Tata Chemicals Q3 & 9M FY17 Earnings Call. We have with us today, Mr. R. Mukundan – Managing Director and Mr. John Mulhall – Chief Financial Officer.

Before we begin, I would like to mention that some of the statements made in today's discussion may be forward-looking in nature and may involve risks and uncertainties. A detailed statement in this regard is available in the results presentation. I now invite Mr. Mukundan to begin proceedings of the call.

R. Mukundan

Thank you, Gavin. Thanks everyone for taking time out to join our Q3 & 9M FY17 earnings call. Let me briefly run you through some of the key operational highlights, following which my colleague John will run you through our financial performance for the period.

Our performance for the quarter has been fairly strong as reflected by growth in our numbers. Profitable growth mainly driven by overall improved performance across all business units. These results have been driven by combination of better product mix, lower input cost and strong emphasis on profitable operations. On a standalone basis, our domestic soda ash business faced a steady demand besides the benefit of the low input costs. However, consumer business continues to progress well and we are seeing good customer response for our products, result of which has been that, Tata Salt again stood number one in food category in brand equity survey. We are confident that our growing portfolio, built on innovation and R&D, will help us meet and respond to several earlier untapped needs. We are also happy in the way our spice business is being shaping up and are working towards improving brand visibility and customer connect.

The pulse or the protein business performance remained a bit soft as effect of a spillover of previous quarter. However, we are very confident with the product mix that, which is more on value added side, the business performance would continue to improve in the coming quarter.

Moving on to the farm business – the sale of urea business to Yara, we have received approval from Competition Commission and the deal is progressing well as expected. The SEBI has also cleared the proposal and we have moved the NCLT for giving approval for the court process.

As communicated during last quarter, our Haldia operation performed well in this quarter as expected and has returned to profitable numbers, largely driven by excellent product mix in its categories.

Moving on to international operations – the performance of Europe has remained steady due to cost control and effective benefits coming in from the energy business which was commissioned a year ago. Kenya operation continues to show improvement with the product performance and continues its focus on quality and efficiency during the year. The performance of TCNA was encouraging on the back of operational excellence, consistent prices and production recovery.

Lastly, as most of you know we have signed a MoU with the Government of Andhra Pradesh for setting up a nutraceutical business in Nellore district which will have an investment of approximately Rs. 250 crore. This is an expansion to the pilot plant that we have in Sriperumbudur near Chennai. The planned unit will be about 90 minutes' drive from Chennai in Andhra Pradesh and we think it presents a terrific opportunity of innovation driven businesses and specialty chemical business for the Company. This is one of the two businesses which we are exploring and once the second business also gets a formally clearance from board, we would come back to you all with the news of the same.

To conclude, our stance has been to reduce our exposure to the regulated space, continue to run the commodity space for cash and drive the growth in specialty and consumer facing businesses based on innovation and R&D. We see terrific progress in the strategic direction, the company has undertaken.

Now, I request John to give you some insights on financial performance.

John Mulhall Thanks, Mukundan. Starting with our international business, Tata Chemicals in North America production volumes recovered from the issues we have experienced in 2015 and recorded soda ash production which was 556,000 tons in the quarter compared to 472,000 tons in corresponding quarter last year. UK operations continued their positive performance through a combination of manufacturing efficiencies, lower input cost and fixed cost control. Both business recorded a profit in the quarter. In Kenya the continued focus on its operational efficiency, and quality, again delivering a profit in the quarter.

Consolidated net debt on the 31st December was 5,883 crore, against Rs. 7,830 crore in March 31st, 2016. Moving onto Tata Chemicals India operations, we saw solid operational performance in the chemical business that covers soda ash and salt. We experienced better margins in the phosphate business in Haldia due to change in production and sales mix and lower the input cost which delivered profit in quarter for the business. We displayed sustained operational excellence at our urea facility and increased production by 18,000 tons for the same quarter last year. With continued focus on improved working capital through inventory and debtor's management, it allows us to repay $60 million external commercial borrowing loan in the quarter directly from cash.

And finally, at the quarter end our net debt on the standalone basis was Rs. 1,318 crore, against Rs. 2,937 crore in March 2016.

So, I will open the floor to questions now.

Moderator Thank you very much, sir. We have the first question from the line of Abhijit Akela from IIFL..

Abhijit Akela First question is on the debt, the numbers you gave suggest that the net debt has decreased by almost Rs. 2,000 crore from March to December. So if you could just help us understand what were the key drivers behind this, is there a big push in coming out of working capital? And also, are you expecting any further reduction in debt through March and when do you expect the Yara transaction to close and how much would that cut debt by?

John Mulhall The debt reduction in the quarter really came from debtor and inventory management and that was driven by reduction, as you can in sales by 20% on a quarter basis against last year. So we were not focusing on lower margins traded fertilizer business and we were looking to maximize margins, maximize efficiency in Haldia and our urea business as well. At the same time, we are looking to only manufacture what we can turn quickly into cash. So, the situation in last year, we were manufacturing consistently throughout the year, holding a lot of inventory and selling in the winter season, this time we started production towards the winter, so that we can convert the raw material into cash through debtors very quickly. Even with the demonetization, we still managed to convert the debtors into cash very rapidly. There is no structure difference, just a change in philosophy we had on how we are going to run the lower margin businesses. At the same time, we did repay $60 million ECB loan in October that was from cash, where no new facility has been taken. Going forward, in the rest of the quarter we are not doing anything different, we are just going to continue managing our working capital. We will ultimately plateau at some point on working capital management. The thing I would say that, we still have over Rs. Rs. 1,300 crore of subsidy outstanding, some of that could be alleviated, we will also look at the conditions and terms to see how one sees that facility. So, the guys have done a great job on managing the cash through business, it is in a good position and if there is some decrease, I am expecting a little bit in the final quarter of the year.

As regards to the Yara transaction, you know that is really done to the NCLT to see how long it takes to go through the approval process. We previously guided around June, July and August time, that still stays and that is our best guess as it stands today. And the decision on use of the cash beyond paying tax will be taken by the Board and they will make the decision at the time.

Abhijit Akela How much would the tax be?

John Mulhall We do not know yet, we have to wait for the final date.

Abhijit Akela And then just second, the profit from JVs and associates has turned positive this quarter and there is also a footnote that you have discontinued equity method accounting for Crystal Peak Minerals. So, are the two of them linked together, is that why the profit from associates has turned positive and what should we expect that line to do going forward?

R. Mukundan About six months ago we had reported during the investor call, that there was a fire in the generator which shut down their power unit. IMACID also earns, while making phosphoric acid, money through selling electricity to the grid. And that earning had stopped completely and that also meant that our ability to manage the operations had substantially reduced and we were in fact buying power instead of selling power. So the entire energy mix had completely changed which had switched back with the generator coming on stream, and hence this quarter reflects what would be normally expected in IMACID.

Abhijit Akela The consumer business, by when can we expect the pulses business to start showing improvement? And if there is any financials you could disclose about nutraceuticals project that you have in Nellore? Thank you so much.

R. Mukundan So, as far as pulses is concerned, I think we are expecting somewhere during the next year that one of the two businesses would turn positive at the PBT level. We hope and let you know when that happens. But we are extremely focused on driving that and the team has taken all the necessary steps to move it in the right direction and I would expect it sooner than later, that is anyone between pulses and spice one of them will turn profitable. But that does not mean, we will stop investing in that business, those businesses would continue to get our support in terms of marketing and investment support, because we see a huge potential in growing these businesses going forward and we see them adding similar turnover to what salt turnover is today and also to the bottom-line going forward.

As far as the nutraceutical business is concerned, most of the specialty businesses have certain range of return on investment. I would suggest that if you took a base line number of that from the other return on investment categories, I think this would fall fairly in that spot. This behaves like specialty chemicals and not like commodity chemicals. So this investment of approximately Rs. 250 crore should give us returns in the same range.

Moderator Thank you. We have the next question from the line of Prakash Goel from ICICI Securities. Please go ahead.

Prakash Goel So, two questions, one with respect to the improved profitability in the fertilizer segment. So what has changed out there, sir?

R. Mukundan So, as far as urea is concerned it is clearly the production numbers which has been the focus on driving excellence and Q3, Q4 generally tend to be better months for energy efficiency because the weather is cold. So, summer months it tends to be weak and relatively more energy intensive than the winter months, which is really what, is happening on urea.

Prakash Goel Sorry I am cutting here, when we are looking at the segmental performance I am presuming that urea is not included, it is just the NPK?

R. Mukundan I am coming to that. So, as far as NPK is concerned, as John said, we have shifted the product mix to short cycle sales, which means we produce and sale, we are not producing products which have long stocking period and will convert quickly to cash. And also there has been a reduction in the phos acid prices at which we contracted for the quarter which has helped us. And as it stands today, the phos acid prices negotiated are in sync with what normally be needed as sustainable profit of that site

Prakash Goel And second question with respect to the outlook on Soda ash. How things are panning out in GCIP because we are seeing a quarter-over-quarter drop in profitability?

R. Mukundan So, TCNA I think that is really not, I think we have done an excellent performance, we do not see any drop in profitability. I think the season has been a better performance, I do not know which set of numbers we are looking at. So if you can guide us…

Prakash Goel GCIP I am talking about the segment EBIT, there is marginal drop, not a big drop. from Rs. 189 crore become Rs. 170 crore QoQ.

R. Mukundan Yes, I think that is because, every quarter we take some minor shut and also this would be depending on the product mix between exports and domestic sales. So this is a minor movement. But what currently is reflected are the quarters of TCNA we would think are reflective of their current steady operations.

Prakash Goel I was under the impression that Q2 there was further scope for improvement because the things got stabilized during Q2, Q3 onwards we were looking for some improvement in the US operations.

John Mulhall Yes, and we saw that, there is no concern about that. We do take some major shut down, 10,000 tons either way that is a day and half's production, that can happen very, very easily.

Prakash Goel So, the profit that we have reported during the last two quarters, if we look at the average of that that should be a steady profitability going forward if the rate does not move?

R. Mukundan Yes, if you want to make that assumption, that is fine.

Moderator Thank you. We have the next question from the line of Abhijeet Dey from BNP Paribas Mutual Funds.

Abjijeet Dey Two or three questions from on my side, sir, what is the trend in domestic soda ash prices sir, especially after coal prices have also corrected?

R. Mukundan So, in terms of domestic prices we are seeing no change, we in fact expect some change to happen sometime after the first quarter of next year when the anti-dumping duty goes away which will have two affects, one is the domestic producer's realization will drop and the import price will increase. So, for us we have to calculate the net-off, because we do bring in material from Kenya and US into India, so we will calculate that. But that's really the expectation and it will be priced into next year's end of first quarter. As far as the cost issue is concerned, you are right that there is a cost pressure on the business arising out of the coal price increase as well as coking coal price increase. The coal has softened a bit so energy cost may come back to what the norm is, but coking coal we are seeing no reduction. So, it is about I think Rs. 600 to Rs. 700 impact on per ton at the cost basis which we have not passed on to the market, most of the producers have absorbed that. We are certainly working on what is the right product mix in our site at Mithapur because we have flexibility of switching between several products including soda ash and other products we make there. So we will make appropriate decision as we go forward.

Abjijeet Dey Sir, I am sorry if I missed that earlier, but what has been the performance of your branded division sale, especially pulses which showed a loss last quarter.

R. Mukundan There has been no one-time write down this quarter, it is just steady operation, we have been liquidating stock. And the fresh buying has just begun and I think in the quarter four we will be able to report result of the fresh buying.

Abjijeet Dey And lastly sir, if I can go back to soda ash, has there been any increase in prices in the US market in the new year?

R. Mukundan No, I think we have had more or less stable number in the new regime, there has been no increase which is a little bit surprising considering that southeast Asian market there was a spike in prices. So, I think all in all, while the southeast Asian prices have spiked up, more or less the pricing is stable everywhere else.

Moderator Thank you, we has the next question from the line of Alok Deshpande from HSBC.

Alok Deshpande My first question is regarding the domestic chemicals margins this quarter, so I believe the margins had gone up in Q3. Where do you see the outlook for this margin going for the next couple of quarters?

R. Mukundan As I said, the quarter four we certainly will have the impact of coke price increase should land somewhere between Rs. 600 to Rs. 700 per ton. I think that impact which is reflected going forward if coke prices do not correct. My own anticipation of coke prices correcting is somewhere around first quarter or second quarter of next year as the production ramps up or Chinese producers wind down the steel production. So you can follow the steel industry and what is happening in steel production in China is a good indicator of coke prices going ahead.

Alok Deshpande And sir, second question was regarding to the US TCNA debt profile. Now, I believe there is about a $200 million of net debt there, so what is the repayment schedule for US specifically and is it that you are going to sort of repay through only US operations?

John Mulhall See, you are quite right, the net debt number are near around that. That was a seven-year facility which we have got in 2013 so it is a very minimal amortization. We took the opportunity as we built up the cash there to repay that debt. We paid $30 million through that piece. So we will keep an eye on that, we do hold that amount of cash on the balance sheet in North America and we do distribute some dividend and we will be holding back up to our operation. So we manage that but there is no concern about the level of the debt in North America.

Alok Deshpande So, by 2020 we should be in a position to entirely pay off the debt or how do we look at it?

John Mulhall It would be a strategic decision taken near the time on how we pay off the debt for North America.

Alok Deshpande Last question, have we taken any price hikes in domestic branded salt?

John Mulhall No we haven't.

Moderator Thank you. We have the next question from the line of Saket Kapoor from Kapoor & Co.

Saket Kapoor Sir, there is also an anticipation of capacity of soda ash coming up from Turkey, what is your take on that and as you were assuming that the anti-dumping duty should be going away, what kind of impact can it have on the realization domestically for us?

R. Mukundan Yes, I think when I said, there was a question about the US and prices across regions, I mentioned that while prices had spiked up in Southeast Asia, in most of the markets, the prices are where almost steady because that's in anticipation of some material coming in towards the end of 2017 or early 2018. We do not have a clear determination when the ramp-up will happen, how the ramp-up will happen. But certainly by 2018 the material should be in, so we may have somewhere between nine to twelve months available as a window for the current pricing regime to continue. Post that, we do anticipate there will be some dislocation in the global pricing which may be $10 to $15, so we do not know exact number but certainly there will be a dislocation. But this dislocation should not continue forever in my view because the global demand also is increasing at the rate of anywhere between 0.5 million tons to 1 million ton every year. So, the entire capacity which is coming on should get absorbed in about three years' time. The good news is Chinese are cutting down their capacity and we also expect certain capacity shut downs in Europe, which is why I am not making any definitive statement on what exactly will happen. But even if there is a dislocation, this market is going to continue to be tight because starting up new capacity beyond this in turkey is going to be difficult and no fresh capacity in synthetic side is being built because any investment being made on synthetic side, the market prices are not high enough for anyone to justify adequate returns.

Saket Kapoor And sir, this being a dense commodity, how much can this duty structure getting away can affect the market? Do you think the substantial amount or quantity coming into the system, just the duty is allowing it to protect?

R. Mukundan No, I do not think so. I think the duty protection was needed at a given point in time. I think industry has re-structured and got its cost structure down. So industry is well-prepared to meet the challenge. And industry in fact has restarted to export materials out of India. In fact we have seen the first consignment going to different markets last quarter itself and industry would continue to shift the material out if there is any surplus which is available to be shipped out. As we speak today, the international realizations are attractive enough to export, especially realizations in Southeast Asia. So, I think the issue is what is going to be the situation in year FY18, FY19, the two years where there will be surplus in the world market, if the Turkish capacity comes on stream and no capacity shutdown happens in China or in Europe. So, to that extent I think there will be a bit of an impact, whether that impact will be felt in the Asian market or South American market, we do not know as yet, it will be in the market, where Turkish players have better net backs. So, clearly crossing the Suez is the more expensive situation then taking it to other market. So, I think as long as Suez Canal crossing is going to be expensive, we should be protected this side.

Saket Kapoor Sir last part on demonetization front, how have demonetization aspect affected the domestic market in soda ash for us, if any?

R. Mukundan Demonetization, we have not had the kind of impact which we thought it will have. So we have had a very benign situation as far as we are concerned. The big issue was in the initial period there was dislocation of transports because the truckers did not have enough trucks moving around. So there was a bit of a pile up of material for first 15 - 20 days in our plant, but that has now more or less it has smoothened out. So, except for material movement dislocation, I think, happened because the transport industry got impacted, we did not see much of an impact, we also did not see any slowdown in demand for our products. I think this is now well behind us, and since we have ridden the wave with a very minimal impact on the company, you see going forward it is going to be only positive.

Saket Kapoor So, there is no inventory pile up in our end also on account of it?

R. Mukundan It was there for about 15 days. I said, because there was a shortage of trucks. Mainly the trucking industry did not have cash because they run the business on cash, I think that was an unintended consequence of the whole demonetization. Other than that we faced no difficulty but we have overcome that 15 days, it was only the first 15 days.

Moderator Thank you. We have the next question from the line of Dipen Sheth from HDFC Securities..

Dipen Sheth I just had one question regarding the pulses and spices business that we do. Where is this revenue accounted for in the four segments, in others?

R. Mukundan Yes, it is accounted in others.

Dipen Sheth So that is Rs. 327 crore for the year-to-date December 2016 and Rs. 91 crore for this last quarter which has just gone by, right?

R. Mukundan That is right.

Dipen Sheth So, is this entirely that part of the business or is there something other in others, if I may ask?

R. Mukundan Essentially these two.

Dipen Sheth Essentially these two product lines, but salt is subsumed in the inorganic chemical segment?

R. Mukundan Yes, correct.

Dipen Sheth And if not on the call then offline, can you share the split between salt and soda ash in that line?

R. Mukundan No, we do not normally do it.

Moderator Thank you. We have the next question from the line of Devendra Bhandari from Joindre Capital.

Devendra Bhandari Sir, I want to know what the net result of urea is in this quarter, I mean, fertilizer segment what is the urea and NPK?

R. Mukundan So, there is actually shown a split if you see the discontinued operation that is entirely urea and what is shown as fertilizer is NPK.

Devendra Bhandari So urea business is not shown at all?

R. Mukundan I think in the segment result it is coming at the bottom called discontinued operations, if you see the note. If you go to the Page #2 of the SEBI sheet, it will be there.

Moderator Thank you. We have the next question from the line of Manish Ostwal from Nirmal Bang.

Manish Ostwal Sir I have a question on, this NPK performance YTD has fallen quite sharply. So could you explain the reason and what is your outlook going ahead?

R. Mukundan So, I think NPK segment YTD first two quarters of this year, as John had explained, we had changed the philosophy during the year to produce only if it is profitable and hence we not just dropped the revenue we also dropped the margin. And I think the phos acid prices as well as our product mix has shifted to profitable operations, we ran the plant almost full capacity this quarter. And hence this quarter the Haldia business has seen return to profitability.

Manish Ostwal And what is the outlook going ahead?

R. Mukundan Going ahead if the acid prices remain where they are and the DAP prices are stable. We do expect the margins to be retained where they are.

Moderator Thank you. We have the next question from the line of Sanjay Shah from KSA Securities.

Sanjay Shah Sir, can you guide me on after this post government intervention on capping the prices for pulses, how do you see the future ahead for this?

R. Mukundan Pulses, capping is more or less over, the pulse prices have fallen so sharply because of fresh arrivals in the market place. As I said, we have liquidated our stock through Q3 and to meet the future demand, we have started fresh buying which is at much lower prices. So we see this has returned to normalcy.

Sanjay Shah Sir, we have reduced our consolidated debt by approximately Rs. 2,000 crore, but I do not see that our finance cost going down, it is around Rs. 108 crore or Rs. 109

crore odd from Rs. 91 crore. So, can we see that falling from the fourth quarter onwards?

John Mulhall Finance cost includes effect of mark-to-market, calculations for various loans, interest rate swaps, hedge swaps and some of the expense related to pension. So, there is a lot of things in that finance number, they not true to financial interest. That is absolutely correct, you would expect to see cash interest falling based on the cash flow that we have.

Moderator Thank you. We have the next question from the line of Sumant Kumar from Emkay Global. Please go ahead.

Sumant Kumar My question is regarding salt business, so how is the margin in the segment?

R. Mukundan The margin is stable, so we see no impact on the margins expect that the overall issue related to energy which did impact, but very marginally because it is not a very energy-intensive business. And the other thing which we were watching very closely was the trade market, how it is going to move ahead because it is a freight intensive product and thankfully the railway budget did not have any big negatives for us. So, on both these we had a very limited impact.

Moderator Thank you. We have the next question from the line of Trilok Agarwal from Birla Insurance.

Trilok Agarwal I wanted to check on this complex fertilizer business, last year we had seen government intervention with regards to the lowering of subsidy in the wake of falling raw material prices. Could you see such kind of similar actions given that they typically announce for the next financial year?

R. Mukundan So, I cannot say for sure what they will do. But certainly I think the industry has made several representations that for it to sustain it needs profitable operation and I think government does recognize it. Secondly, as John has said we have done two things in our complex fertilizers which will mean a very different set of fresh numbers coming through, one is we are going to produce only when it is profitable, so when we produce it will deliver profits. And secondly, we are going to produce very close to demand cycle. So our cash conversion will be much faster. So we will shut the plant down whenever there is a need for heavy inventory utilization and start the plant when it is closer to market demand. So, these are two shifts in philosophy which is our way of operating the business. And this mean there will be periods, when there will be losses reported by the business because we are not running. And when we run we will report certainly profits.

Trilok Agarwal So, utilization levels probably will be very, very seasonal in that context you are trying to say, going ahead?

R. Mukundan We are aware of it, but we think that is the right way to run the business, we want to run the business for maximizing cash and not get any cash locked up in the system.

Trilok Agarwal And one more point on the same, so would you also be refraining from manufacturing DAP given that it is getting incrementally more commoditized?

R. Mukundan No, really it depends on the product mix, for example, last quarter we actually pushed up ramped up the production because DAP was more profitable than some other complexes. So we produced 72,000 MT as against nil or zero of similar quarter previous year. So the product mix decision will be taken from time to time.

Trilok Agarwal And one final, if I may, what is your thoughts on continuing this business or would you like to even hive off just like the urea business going ahead?

R. Mukundan We have made reference to this in several calls, we have said that there is no capital allocation being made to this business, we are giving bare minimum sustenance capital. And also we changed the philosophy and even tighter control of running it very close to cash cycle so that we do not lock up any cash, working capital in this business. So that reflects the way we will run the business. That should be enough indicator of what we are intending to do.

Moderator Thank you. Ladies and gentlemen, this was the last question for today. I would now like to hand over the floor to the management for their closing comments. Over to you, sir.

R. Mukundan Thank you very much for this call. And all we want to reiterate again is our strategy is going to continue to focus on ensuring that we tightened the capital's expenditure towards businesses which are in our view more specialty and more consumer and run the rest of the business for cash and as tightly as possible. Thank you