TATA CHEMICALS LIMITED

Q1 FY2012 – Earnings Conference Call Transcript
August 9, 2011 at 11:00 am IST

Moderator: Ladies and gentlemen, good day and welcome to the Tata Chemicals Q1 FY12 Conference Call hosted by UBS Securities India Private Limited. As a reminder for the duration of this conference, all participants' line will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference call, please signal an operator by pressing "*" and then "0" on your touch-tone telephone. Please note that this conference is being recorded. At this time, I would like to hand the conference over to Mr. Ajay Nandanwar, Director Equity Research UBS. Thank you and over to you.

Ajay Nandanwar: On behalf of UBS and Tata Chemicals, I welcome you all to the results conference call. We have with us the management team of Tata Chemicals Limited. I would now like to hand over the floor over to Mr. Mukundan, over to you sir.

R Mukundan: Let me welcome my colleagues, Mr. P. K. Ghose and Mr. Ranjeev Lodha to this call. I will begin by giving an overall perspective on our operating performance for quarter ended June 30, 2011, following which Mr. P. K. Ghose will share the financial details.

The demand situation across all our product segments remains strong, especially in the fertiliser and the crop protection segment despite the challenges burgeoning in the world. We also believe that given the breadth of geographic spread in our soda ash sales, we will not be impacted even if it there is a sharp decline as a result of the economic issues around the world. Nonetheless, we are keeping a very careful watch. Overall, we have built a very low cost position across all our products, which will help us even if the time turns challenging going forward.

During the quarter, the performance in the fertiliser segment was impacted primarily due to the recent Government circular, which has had an adverse impact of Rs. 31 crore at the income level and an impact of approx. Rs. 23 crore at PBT level and PAT level. Barring this, we believe that our performance has been optimal. On the potash front, we would have certainly liked to secure the supplies much earlier than what we have which could have allowed us to ramp up the NPK production much faster. However, the impact of the delay in tying up the potash supplies will be fully seen in the Q2 FY12 where the DAP production will be on schedule but the NPK production will be subdued.

One of the key strategic initiatives that we have taken over the last few quarters is to acquire strategic stakes across all the key products that we are present in. We already have access to natural resources in soda ash, urea in Gabon, phosphate in Morocco, and for potash, we have a sulphate or potash resource access, which is in US through the EPM acquisition.

In terms of segment wise performance, the demand for soda ash in the domestic market is healthy and we continue to see an uptick in realizations in the international market. The current demand-supply situation is certainly quite tight around the world, which is one of the reasons that some of the key suppliers are increasing prices by USD 50, which would translate into earnings improvement for the balance period of the year at least by USD 10-15 per ton. In Europe, we do see continuing impact of the extreme winter. However, the repair work has been completed and we believe, going forward i.e. from August-September, the capacity will resume at normal levels. The performance in British Salt has been well ahead of our expectations and we believe it would continue to be so. In terms of Tata Chemicals Magadi, while the capacity utilizations and volumes have improved, the key issue has been with respect to the impact of high energy cost. Our US operations have done well both, in terms of volumes as well as EBITDA numbers and we expect the trend to continue.

With respect to the fertiliser operations at Babrala, we have stabilized operations and are running consistently as of now. However, muted performance during the current quarter is attributable to two reasons a) approx. Rs. 18 crore of LOP in Q1 FY11 and b) in the corresponding quarter of last year, there was a part movement of material which had moved between two quarters which gave us ~Rs. 6-7 crore additional profit, which got smoothened out by Q2 FY11. Hence, there was a Rs. 24 crore movement in profit between last year and this year, which explains the basic underlying performance of Babrala; otherwise, the plant is performing well and we believe that the strong international prices and the IPP volumes at the end of the year will auger well for the fertiliser business.

The projects for debottlenecking capacities at both, Mithapur by one more line for salt and SSP capacity by 50,000 tons in Haldia are proceeding as per schedule. Our salt market share continues to be at 63.2% and the two nascent businesses, Swach and I-Shakti pulses continue to move as per the plan. However, these businesses have no major contribution to the bottom line currently and the benefits of these businesses would start reflecting after a few years from now. Rallis, a subsidiary of Tata Chemicals has reported a robust growth. Please note that the Q1 FY12 performance of Rallis includes the results of Metahelix. Going forward, the Dahej plant, which has now been commissioned, will contribute significantly to the performance of Rallis.

Overall, we certainly have put our businesses on a very strong footing and believe that these businesses will start yielding positive results going forward. In our view, the perception is worse than reality and hopefully the markets will acknowledge the same and move on from here. I now request Mr. P. K. Ghose to give insights into the financial performance.

P. K. Ghose: Let me give you the headlines on the consolidated financial results for this quarter. Net sales for Q1 FY2012 were higher by approximately 17.1% at Rs. 2,954 crore. Profit from operations stood at Rs. 527 crore compared to Rs. 518 for the corresponding period of previous year. Profit before tax is at Rs. 320 crore vis-à-vis Rs. 322 crore in the previous year. PAT after minority interest for the period stood at Rs. 200

crore. As Mr. Mukundan mentioned earlier, the Company has not recognized subsidy income of Rs. 31 crore on the opening stock of raw material of phosphatic and potassic fertilisers in accordance with the recent government circular of July 2011 issued by the Department of the Fertilisers, with respect to raw materials and finished goods subsidy. The corresponding profit after tax for Q1 FY2012 includes the impact of Rs. 23 crore in accordance with the said circular. TCL as along with the industry is contesting this circular. I would also like to remind you that in the corresponding quarter of last year the operating profit got a boost from exceptional one-time gain in the fertiliser segment. Inventory gains arising from cheaper phosphoric acid produced in Q4 FY10 also pushed up revenues and profits by Rs. 20 crore.

Moving onto the balance sheet, the consolidated net debt as on June 30, 2011 stood at Rs. 5,698 crore translating into a net debt to equity of 0.74:1. Total cash and cash equivalent amounted to Rs. 1,545 crore.

The global economic environment continues to be fluid with problems of liquidity and inflation. The recent downgrade by the US has only made the sentiment more fragile. While the impact on developed markets may be the most, there may be some knock on effects on emerging economies and therefore the Indian Government policies will be key. It will also be interesting to see how RBI reacts in future.

In conclusion, I would say that the overall performance in the quarter has been strong but we continue to trade forward with cautious optimism. I would now like to throw the floor open for any Q&A. Thank you.

Moderator: We will now begin the question and answer session. The first question is from the line of Samanta Khan from ICICI Prudential.

Samanta Khan: The sales volumes from Europe have gone down considerably Y-o-Y as well as Q-o-Q. Is there anything particular we should be aware of because of this fall?

R Mukundan: Last year in December, Europe went through one of the most severe winters, which had an impact on the plant and machinery. While we are recovering from this, there were some equipment's that needed repairs till the end of the quarter. However, these equipment's have now been repaired and from August or September, onwards we should be back to normal capacity.

Samanta Khan: What is your view on the realizations for Europe?

R Mukundan: The realizations are pretty much on target. The one issue certainly which was running ahead but has now come under control is the coke prices. They are back to where we wanted it to be. So the only issue I would say, we need to watch out in UK is fundamentally the volumes and once they come back, the performance of UK would be on target.

Moderator: Thank you. The next question is from the line of Atul Rastogi from RBS.

Atul Rastogi: Can you throw some light on the urea policy? Have you heard anything in terms of NBS proposals, will the price hike be effective 1st October?

R Mukundan: The price hike is not known and all that the policy is saying is that it is going to allow a maximum of 10%. It does not translate itself to immediate increase in prices. It – frees up the market to an extent and fundamentally, it allows a fixed subsidy to be given to firms with an additional special subsidy, which will be coming down year on year. Effectively, that will force the companies either to get efficient or to pass on the increase in cost to the marketplace within that band of 10%. Hence, it would cap the government's expenditure in subsidy and make the overall scheme of things more balanced. If you look at the urea prices in India, there is a wasteful use of urea and less consumption of potassium and phosphate, so this will balance the nutrients. So, this policy is supposed to achieve 3 key points a) balanced use of nutrients, b) lower subsidy bill and c) ensure increase availability and reward efficient player. However, we cannot speculate on pricing. All we could say is that, it allows the degree of freedom to companies to manage their affairs better.

Atul Rastogi: You would not say that your realizations would increase at least in the near term when the policy is implemented.

R Mukundan: All I would say is that the companies that are performing better would see their profits go up even if the current numbers were to stay as it is.

Atul Rastogi: The other expenditure seems to have gone up quite a bit in this quarter compared to the last quarter. Is there any other element apart from what you have mentioned already?

P. K. Ghose: It is mainly due to higher hedging costs. The hedging costs are higher because we import lot of the material, both for trading and manufacturing at Haldia. That is the key element, which has contributed to the increase.

Atul Rastogi: Is it a one-time expense?

P. K. Ghose: It depends on the volumes that come in. If you trade more volumes of MOP, DAP etc. then it will go up.

Moderator: Thank you. The next question is from the line of Falguni Datta from Jet Age Securities.

Falguni Datta: My question is again on this draft urea your policy, which the GoM has cleared. Is there more detail you can share in terms of the dynamics and how much Tata Chemicals would benefit?

R Mukundan: All we have to say is that at this point of time is that the final policy is not yet out and we only know the draft elements for the policy.

Moderator: Thank you. The next question is from the line of Nitin Gosar from Religare.

Nitin Gosar: Can you help us in understanding as to what has impacted the bottom-line performance of IMACID?

P. K. Ghose: Input prices like rock phosphate went up significantly during the period. This has impacted the bottom-line.

Nitin Gosar: What is the kind of payback framework you look forward for the branded salt expansion, which is going to be completed by March 2012?

P. K. Ghose: It is a 200,000 ton plant and it meets our internal criteria. We set out a target to have a return on capital of 20%.

Nitin Gosar: The performance of Tata Chemicals India operations seems to be weak. Could you broadly clarify?

P. K. Ghose: There were three reasons for this. a) LOP of Rs. 18 crore b) Rs.6 crore was the low-cost inventory that led to a higher margin in Babrala last year and c) we have provided for carryover stocks, as per the notification by the department of fertiliser, which is about Rs. 23 crore. If you add these, you would have the total impact of approx. Rs. 47 crore.

Moderator: Thank you. The next question is from the line of Varun Guntapalli from Edelweiss, please go ahead.

Varun Guntapalli: With regards to the notification, have you also considered finished goods in the opening stock?

P. K. Ghose: We have not challenged the finished goods pricing. Our view is that it may be only fair that the inventory gains on the finished goods be mopped up. While we have not taken a definitive view, our view is quite strong on the raw material side. That is why we have given a note to the accounts and we are going to challenge that. As far as the finished goods is concerned they have been valued lower and hence we have done exactly what we have done in for the raw materials but we have not given the notes specifically on finished goods.

Varun Guntapalli: Would there be a similar kind of impact in Q2 as well

R Mukundan: The issue is that this number is usually decided annually and the problem with the production process of DAP is such that the shipments, by the time you look at the entire supply chain, are almost 2 months long. This is a problem peculiar to DAP production where the supply chain in itself is extremely long and the pipeline stocks value keeps moving up and down. So, it is difficult to say. We propose to raise the issue with the Government.

Varun Guntapalli: What is the basis of your calculation of Rs. 30 crore?

R Mukundan: It is based on the NBS scheme where the nutrient value is given a subsidy and the subsidy that the government has indicated is a lower number. So, the income is lower to that extent. Even though the announcement was for a higher number, they said whatever inventory you have as on April 1, 2011, we will treat it at a lower number. Hence, whatever production we have done using that stock, we have valued it at a lower value.

Varun Guntapalli: With regard to the MOP negotiation, what are the volumes that we have contracted for the second half of this year?

R Mukundan: The press release of Canpotex said is at 6.7 lac tonnes at USD 470.

Varun Guntapalli: Is 6.70 lac tonnes entirely for Tata Chemicals?

R Mukundan: No, it is split between Tata Chemicals and Coromandal equally.

Varun Guntapalli: Will it suffice our requirement or will we require more volumes of MOP?

R Mukundan: We would have certainly liked more volumes, but I think the supply situation for MOP is quite tight and that remains an issues. Therefore, we will be exploring if we can get access to more volumes.

Moderator: Thank you. The next question is from the line of Bharath Subramanian from Sundaram Mutual Fund, please go ahead.

Bharath Subramanian: Could you throw some color on the performance of British salt in this quarter?

P. K. Ghose: British Salt had a turnover of about Rs. 71 crore with EBITDA margins of 52%.

Bharath Subramanian: In terms of the overall debt, could you just break it down in terms of subsidiary wise, what would be the gross debt level?

P. K. Ghose: The total debt is about Rs. 5,836 crore out of which roughly Rs. 2,900 crore will be debt on Indian balance sheet. Debt at Tata Chemicals North America will be about USD190 million. Please note that these are rounded figures. Kenya will be about USD 50-60 million and the balance will be UK and British Salt, which will be about £150 million including working capital borrowings.

Bharath Subramanian: In terms of the potash, what would be the rough impact in terms of volumes compared to last year?

R Mukundan: We are just waiting for the vessel arrival dates and only then, we will know the impact. The strategy is to shift to DAP and cut back on NPK for some period and then restart once the material comes. We do anticipate a gap in between our stock running out and vessel arrival.

Bharath Subramanian: If we were to do any further debottlenecking, how would that be in terms of policy? Would it come under the existing IPP policy?

R Mukundan: The debottlenecking has already been done and is covered as per the old investment policy and that does not change..

Bharath Subramanian: Do you have any further plans for debottlenecking?

R Mukundan: We will evaluate when the new Policy framework is in place

Moderator: Thank you. The next question is from the line of Prasad Deshmukh from DSP Merrill Lynch, please go ahead.

Prasad Deshmukh: How have our margins moved on the DAP front given the way raw material prices and finished goods prices are moving and what is your outlook going forward?

R Mukundan: DAP contribution will be almost similar to last year, which is more than about Rs. 3,500 a ton.

Prasad Deshmukh: Going ahead do you see any pressure there because of DAP prices may come down and rock phosphate prices don't seem to be coming down?

R Mukundan: We actually see continuing tightness across potash, phosphate and even urea. In Phosphate, the supplies are not yet kicking in at the same rate as supplies are going out. In potash, the kind of mine closures and mine starts, which are happening, again does not play out well. In urea, the whole issue is about capacity versus the demand situation. With regard to your question about rock price moving ahead of DAP, right now I think, overall the input costs have moved up and the price of DAP has also moved in tandem without compressing the margins. We do anticipate that it could continue in that same manner.

Prasad Deshmukh: You mentioned that the efficient urea plants would make more money. So, In terms of thermal efficiency, how are we stacked up against the industry per se?

R Mukundan: It is not vis-à-vis industry, actually there is a normative efficiency which is given for each group which is let's say pre 92 has got one number and post 92 has got another number and vis-à-vis the norms, units like Tata chemicals are slightly better.

Prasad Deshmukh: Is the tying up of raw materials for NPK in place for the rest of the year or are we still in the process of tying it up?

R Mukundan: We never had an issue with ammonia and phosphoric acid. I think the full year supplies for NPK is complete. The issue is the delay in receipt.

Moderator: Thank you. The next question is from the line of Gauri Anand from MF Global. Please go ahead.

Gauri Anand: One is phosphoric acid as well as MOP costs have gone up for you. So do you intend taking price hikes?

R Mukundan: I think the announcement by the government also was that somewhere around September, the industry will have to move the prices up because the arrivals of acids will be at a fresh set of prices which are certainly higher.

Gauri Anand: So would that mean that the margins will come down in phosphates in Q2 FY12?

R Mukundan: There is the element here that the price issue is mainly for DAP; NPK prices move more flexibly and people who produce complex have greater degree of flexibility. Secondly, I think there will be a carryover stock of asset of the previous quarter, which usually would come into play and hence margins would get managed.

Gauri Anand: The revenues for British Sat have come down whereas EBITDA has gone up vis-à-vis Q4 FY11. Just wanted to know, what could have helped this kind of margin improvement and how much of this is sustainable?

P. K. Ghose: Q4 FY11 was an aberration because when we acquired British Salt, it was very clear that the margins are 50% plus. During Q4, the mix was different and operations were impacted by the severe winter. We are now back to the normal levels and this kind of margins are sustainable.

Gauri Anand: Could you explain the difference between PBT and PAT of TCNA?

P. K. Ghose: It will be the minority interest.

Gauri Anand: In last quarter, you guided for higher tax rate of 18%.

P. K. Ghose: We are at similar levels.

Gauri Anand: In the press release, you have mentioned that you have taken price hikes in soda ash at Magadi as well as in North America to offset cost pressure. So, would it only offset cost pressure or would margins also improve?

P. K. Ghose: We expect margins in both, TCM & TCNA to improve.

Gauri Anand: When are these price hikes effective from?

R Mukundan: The price hikes are already effective from first 1st of January this year. The price hikes in America and UK have all been taken on 1st January. Magadi has taken a further price hike I think, in this quarter of about USD 15-20 per ton.

Gauri Anand: In TCNA have we already taken a price hike or we are still about to take?

R Mukundan: The industry there itself announced about USD 50 increase, but, I think the actual price increases taken is only about USD 10 so far.

Moderator: Thank you. The next question is from the line of Apurva Shah from Dalal & Broacha, please go ahead.

Apurva Shah: How are our pulses and Swach businesses progressing?

R Mukundan: Both these businesses are progressing well; but as I said in terms of starting to contribute to the bottom line, you have to wait for a couple of years because we are still in a buildup phase. So, we would report the quantities but on profit I think, we will start reporting that only in a couple of years.

Apurva Shah: What are the target volumes for pulses for the year?

R Mukundan: We are targeting 20,000 tons for this year and are pretty much hoping to finish the year at the same number.

Apurva Shah: How much is our controlling stake in EPM and cost of acquisition?

R Mukundan: Our stake in EPM is about 15.7% and it is the diluted stake as it stands today.

P. K. Ghose: This stake was acquired for USD 12 million.

Moderator: Thank you. The next question is from the line of Nitin Gosar from Religare, please go ahead.

Nitin Gosar: What is the competitive scenario in Indian market for soda ash now?

R Mukundan: I think, the situation in Indian market continues to be tight. We are net importer of soda ash as you may be aware. Our imports have been growing year-on-year and that continues. In fact, we are looking at capacity expansion in Tata Chemicals North America to feed the market here because, the place where we believe the low-cost expansion can be done is the US and it can feed the growing Indian market.

Nitin Gosar: How is the competitive scenario in UK?

R Mukundan: In terms of Europe in general, not in UK, there was an issue of Eti Soda of Turkey's soda capacity coming on stream, which depressed the pricing for a while; but that capacity has been absorbed, and the situation is back to normal and the market is more balanced.

Moderator: Thank you. The next question is from the line of Gaurav Jain from CRISIL, please go ahead.

Gaurav Jain: If they allow you to hike the urea price by 10% then what is the impact you see on the urea volumes.

R Mukundan: There is no impact on urea volumes. Given its application, we actually see no issue at all on the demand side.

Gaurav Jain: So the farmers will be able to absorb the hike in prices?

R Mukundan: The real issue for a farmer is the issue related to the minimum support price and the market prices of his produce and these have been running at quite a good level. This is because the consumer inflation is being driven by food inflation, which really means that the farmer is able to realize higher prices and his margins would support this. The key issue for the farmer is the productivity increase. So, I think, for the farm community, the bigger issue is not pricing, but is availability of fertiliser and again I think, we are too focused on the wrong end of the stick. Hopefully, with the changes in the policy, the availability will become easier and the farmers would then benefit with higher productivity and then the food inflation also ease.

Gaurav Jain: How do you see the impact of this policy on your profitability?

R Mukundan: It is going to be positive as I said, but I do not want to speculate a number till the policy comes out.

Moderator: The next question is from the line of Priti Arora from Kotak Securities. Please go ahead.

Priti Arora: Could you share the growth rate for British Salt on a Y-on-Y basis?

P. K. Ghose: Industrial salt is growing in the range of about 2 to 4% roughly.

Priti Arora: Can you share any numbers in terms of fertiliser trading volumes this quarter?

R Mukundan: It is not substantially different from the corresponding quarter last year.

Priti Arora: How is the soda ash pricing in India now? Have you taken further increase or is it stable?

R Mukundan: It is certainly stable with an upward bias.

Priti Arora: The volumes have remained constant for the last 4 to 5 quarters. So, do we expect a pick up or is this a demand issue or you expect volumes to grow at 5%?

R Mukundan: No, we are not investing for growth in India. We are investing in US for soda ash.

Priti Arora: Has the EBIDTA margin improved in Africa during this quarter?

P. K. Ghose: Yes, EBITDA margins have improved substantially. It was negative in the corresponding period of last year compared to this year. The overall shift would be close to 20%.

Priti Arora: This 20% swing is post the USD 10 price increase, which has come through.

P. K. Ghose: Yes.

Priti Arora: You are not producing STPP anymore?

P. K. Ghose: No. We are not operating STTP anymore.

Moderator: We would be unable to take any further questions. I would now like to hand the floor over to Mr. Ajay Nandanwar for closing comments.

Ajay Nandanwar: Thanks everyone. Thanks Mr. Mukundan, Mr. Ghose, Mr. Lodha. I would request management to make any closing comments.

R Mukundan: We would just close by saying that as has been highlighted last quarter that the chemicals performance continues to be strong and we continue to hold at this level. Fertiliser business would continue to be under pressure. The pressure has certainly increased with this notification, which has come, and we are hopeful that once we will be able to resolve this issue our focus would be on the issues related to increasing of production. At the same time, there are welcome signals from the government in terms of policy which should auger in the long run good for this industry. Thank you.

Moderator: Thank you. On behalf of UBS Securities India Private Limited that concludes this conference. Thank you for joining us.

This is a transcription and may contain transcription errors. The Company or the sender takes no responsibility of such errors, although an effort has been made to ensure high level of accuracy.