

# Tata Chemicals Ltd

## ***Q2FY13 EARNINGS CONFERENCE CALL***

### **MANAGEMENT:**

MR. R. MUKUNDAN – MANAGING DIRECTOR

MR. P.K. GHOSE – EXECUTIVE DIRECTOR & CFO

MR. RANJEEV LODHA – VICE PRESIDENT, FINANCE

MR. SUDHIR DALVI – CHIEF CORPORATE CONTROLLER

### **MODERATOR:**

MR. SIDDHARTHA BHOTIKA – INDIA ECONOMIST, TATA SECURITIES

- Moderator** Ladies and gentlemen, good day and welcome to the Q2 FY 13 Earnings Conference Call of Tata Chemicals Limited hosted by Tata Securities. As a reminder, for the duration of the conference all participants' lines are in 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 this conference call please signal an operator by pressing '\*' and then '0' on your touchtone phone. At this time I would like to hand over the conference over to Mr. Siddhartha Bhotika from Tata Securities, Thank you. And over to you sir.
- Siddhartha Bhotika** On behalf of Tata Securities I welcome you all to the conference call for Tata Chemicals second quarter earnings. From the management side we shall have with us Mr. R. Mukundan -- MD & CEO, and Mr. P.K. Ghose --Executive Director and CFO. I invite Mr. Mukundan for opening remarks, after which we will move on to the question-and-answer session. Thank you and over to you sir.
- R. Mukundan** Firstly let me extend a warm welcome to all of you. We also have our colleagues, Ranjeev Lodha - Vice President, Finance and Sudhir Dalvi - Chief Corporate Controller, on this call. We will start by briefly sharing with you perspectives on our operating performance, post which my colleague, P K Ghose will share with you the financial details, after that we will be happy to answer your queries.
- Firstly, let me start by saying we are encouraged by the performance of the quarter in terms of increase in revenue for Q2, especially a pretty strong performance on the standalone, with both the increase in revenue and operating profits which then filtered down to profit after tax. This improved performance in the current quarter compared to previous quarter of the financial year has been truly reflective of the fact that all our operations have run as per the plan.
- While the consolidated revenues grew by 17%, there has been a marginal drop on EBITDA due to underperformance in two units; Kenya and UK, which I and Mr. Ghose will cover separately in more detail. Going forward, we are hopeful that stable demand across most businesses and improved performance would continue to further push the operational performance ahead. We continue to maintain a cautious approach on the pricing pressure in Soda Ash business, especially in the South East Asian market. Also the fact that the profit pressures on Phosphatic Fertilizer would continue to plague that segment of the business.
- As far as India is concerned, Soda Ash demand both in Bicarb and Soda Ash internationally and domestically remain stable. The prices are uniform but there are early signs of pressure from Chinese manufacturers. In the current quarter, the production level for the quarter in Tata Chemicals North America was lower than the previous year but in line with our estimate. Growth in exports has ensured that we are sold out for the year. At Magadi, the

lower volumes are mainly on account of dredge outages and resultant non-availability of power and the adverse impact of HFO prices. The Soda Ash operations at Tata Chemicals Europe were hampered by a couple of equipment failures that resulted in slightly lower volumes. However we are hopeful both these issues in Kenya and Tata Chemicals Europe would be addressed during the current quarter and we would move on. Except for these two, I think all other operations had fairly stable, very robust performance, especially at Babrala where the volumes of Urea have breached the post de-bottle necking levels of production i.e. 3500 tons per day. In addition, the demand for DAP and NPK while being adversely impacted, our capacities are fully in tune to meet the market demand if they so arise.

On the Consumer business side, I think we remain market leaders. We are also happy to share with you that Tata Salt was recognized as the "6<sup>th</sup> Highest Brand Equity Award of Economic Times," and we continue to hold ahead of 65% market share in national branded Salt segment.

We achieved highest level sales in H1 for the salt franchise. The Water Purifier business has launched a new variant of Tata Swach at a slightly higher price point and the pulses business continues to witness increased uptake from consumers and also increased brand recognition post our advertising blitz which we launched. The reason we do this focused effort on building brand equity is because we believe that for a good brand consumer pull is very important and it takes time to build the same and we hope to steadily build the consumer pull in the consumer product segment.

Our Specialty Chemicals business which is currently, Rallis, contributed with 11% growth and our efforts are continuing to take our commodity business to a lower cost position so that we are competitive in the long run and transform the company over a period of time to have a higher proportion of Consumer and Specialty businesses. With these words, I now request Mr. Ghose to give his insights on financial performance. Thank you.

**P.K. Ghose**

Let me quickly give you a recap on the financials of Q2 and H1 of 2013. On a consolidated basis, net income for the quarter stood at Rs. 4,197 crores. Profit from operations was at Rs. 661 Crores for the quarter-ended September 30<sup>th</sup>, 2012. Profit before tax amounted to Rs. 439 Crores. Net profit for the quarter stood at Rs. 257 Crores. Our profit for Q2 has been adversely impacted due to various reasons which Mukund mentioned earlier. For the six months ended 30<sup>th</sup> September 2012 net income for six months FY 2013 was higher by approximately 11% at Rs. 7,263 Crores. The profit from operations stood at Rs. 1,156 Crores. Profit before tax was lower by approximately 19% at Rs. 650 Crores, while net profit for the six months stood at Rs. 364 Crores.

Moving on to the balance sheet, the company's consolidated net debt as on 30<sup>th</sup> September 2012 stood at Rs. 4,090 Crores. The total of inventory and trade receivable including subsidies as on 30<sup>th</sup> September 2012 aggregated Rs. 5,013 Crores. This increase was largely on account of outstanding subsidies and fertilizer inventories. Suppliers' credit and buyers' credit continue to be the main source of working capital finance as on 30<sup>th</sup> September 2012. A sum of Rs. 854 Crores of buyers credit and 884 Crores of suppliers credit was outstanding. The recent reform initiative proposed by the Government and the likely reduction in interest rates augur well for the economy as well as to the business. This brings me to the end of my discussion and I would now like to throw the floor open for any questions and answers.

- Moderator** Thank you very much. We will now begin the question-and-answer session. We are going to take a first question from the line of Mukesh Sharaf from Spark Capital. Please go ahead sir.
- Mukesh Sharaf** Firstly, on the IMACID plant I just wanted to know as to why the margins have fallen significantly, because the revenues have obviously come back on track?
- R. Mukundan** On phosphatics, we have long explained that, the value has completely shifted to the rock and inputs. We do believe that this entire value chain will be continuously strained and constrained for Indian manufacturers. Our view on that has not changed. If you ask me, is the profit margin is in line with what we expected this year? It is in line with what we expected this year. Do we expect going forward for profit margins in IMACID to improve? We think it will be sustained at the current levels of margins only. It cannot be improved further and that is our long term view of phosphatic fertilizer, so we remain quite bearish on phosphatic fertilizer.
- Mukesh Sharaf** Just comparing versus last year, we had about 17.5% margins and now close to 6%. So basically the cost of rock has increased so much. Is that the main reason?
- R. Mukundan** It is a combination of rock, sulphur and ammonia all put together and our view the value has shifted away from the people who are converting all these inputs into DAP to the people who own the resources. The business will continue to yield only that much of conversion margin which is reasonable margin for the investment on the ground.
- Mukesh Sharaf** Could you just give us some sense on the ONGC deal? I think there was news about setting up a Urea plant in Tripura?
- R. Mukundan** We are still in discussion. I think the formal arrangements will come in place in due course and till that happens we would not like to make any comments. The news reports have come from various other sources which we would not like to comment further upon.

- Mukesh Sharaf** Could you tell us if there is going to be an investment from our side or are we going to be a partner or we will just be setting up the plant for them?
- R. Mukundan** I would not like to comment; the newspaper reports have actually stated more than what we needed to disclose at this point of time. It remains a joint venture, in case all parties do go ahead post due diligence and other efforts, there will be an investment in terms of equity from all partners.
- Mukesh Sharaf** Anything on the waste to energy plant in UK? There was news on that also.
- R. Mukundan** That is the SEP plant; we have got the environment clearance, but in terms of the specifics of that project and its financials, we will speak about it once it progresses. As of now what we do have on hand is the UK Government has given their environment clearance for go ahead on this project.
- Mukesh Sharaf** Just an update on the Gabon plant?
- R. Mukundan** I think as we said the contracts are being negotiated, the LSTK award has not been finalized as yet. Once it is finalized it is for Olam to announce details; TCL is a minority shareholder in the business. We had given the technical support required for the business. As of now it is fairly resting in terms of the majority shareholder to finalize the terms of LSTK contracts.
- Mukesh Sharaf** Are we seeing some delay in the final commissioning of the plant because earlier the time line was supposed to be mid of 2014?
- P.K. Ghose** The project has marginally delayed by be about two to three months
- Moderator** Thank you. Next question from the line of Abhijit Akella from IIFL, Please go ahead.
- Abhijit Akella** If you could comment on the GCIP, as well as the UK, Africa and the Indian salt operations - where do you see peak achievable production volumes for these units and what kind of timeline are you expecting by when these should be achievable?
- R. Mukundan** I think Salt is already running fairly well both in India and UK. These are the two places we produce and our higher capacity has come into play which is one of the reasons why the volumes in India rose substantially in the inorganic chemicals. I would say that Salt has fully played out. As far as Soda Ash is concerned, in terms of volumes certainly both Kenya and US are already back on stream, more or less up to what the peak capacity should be. In terms of UK, it will take may be a month or so to get the equipment issues in order and then to come back fully on stream.

- Abhijit Akella** So US, we should be expecting around 650,000 tons of production this quarter?
- R. Mukundan** We do not give forward looking numbers, but I think the plant should operate close to its rated capacity.
- Abhijit Akella** On Salt, the sales volumes are only around 10 to 20,000 tonnes higher than what we were doing last year on a quarterly basis
- P.K. Ghose** Your question is that Salt production is only up by a certain amount in these two quarters, the total Salt production we are taking up by approximately 200,000 p.a. and that effect has started just now in the last couple of months or a few months from March onwards or so. So you will see the impact as we go ahead and I think you will see that 200,000 tons will come in due course.
- Abhijit Akella** If you could give us the British Salt revenue and EBITDA number for the second quarter?
- P.K. Ghose** EBITDA margins were lower; because of a mild winter which saw the usage of salt going down, Hence their volumes have fallen because of a very mild winter this time in the UK.
- Abhijit Akella** It would still be in the 40-45% kind of range?
- P.K. Ghose** It is about 43 point odd percent in this quarter vis-à-vis normally they should be doing around 50%
- Abhijit Akella** Excluding Salt, the UK business still seems to be doing only around single digit margins. Do you anticipate any improvement in that or will it sustain only at that level?
- P.K. Ghose** The operating team at UK is working on it. During the first six months and particularly in this quarter, there were some issues connected with the distiller and the calciner which affected their performance. The management of Europe is now chalking out a complete plan of going back to full capacity. I think you should see the production coming back to the level in near future.
- Moderator** Thank you. Next question is from the line of Gauri Anand from Philip Capital, Please go ahead.
- Gauri Anand** Just one question on GCIP. The EBITDA seems to have softened on a Qtr-o-Qtr basis. Could you explain- while volumes are flat and EBITDA has compressed?

- P.K. Ghose** The EBITDA margins in Tata Chemicals North America have declined because of lower sales volume and the lower sales volume have occurred primarily due to some equipment related issues which occurred in Q2.
- Gauri Anand** Are there any expenses which you have incurred and which you have expensed out in this quarter?
- R. Mukundan** One of the things about TCNA is that they opened a new mine face and whenever a new mine face is opened there is an increase in the insolubles and this increase impacts the performance of the entire plant, as a result they have had to incur additional expenses which has slightly compressed the EBIT margins by 2 percentage points or so. But in addition to that, the volume themselves were lower by about 15,000 to 20,000 tons. I think both the volume and the margins would go back to the normal levels, anywhere between 23% to 24%.
- Gauri Anand** You also mentioned in South East Asia, Chinese getting slightly active and you sort of said a word of caution on the prices and you have also started may be negotiating for January. So could you just guide us as to what should we expect in terms of Soda Ash prices going forward and since you would have started negotiations with your consumers?
- R. Mukundan** This is something we would like to comment only at the next quarter in terms of specifics, because most of the contracts would be through by then, but clearly the only place where we believe there is increased aggressiveness by all players and not just the Chinese, is in South East Asia. We do not know the reasons but effectively that seems to be a battle ground where everybody wants to maintain their share and the prices are under pressure in that market. ? We do not expect that to correct in the short run. In other markets the prices are as they ought to be, fairly stable. We also believe it is a reflection of slight slowdown in the Chinese internal consumption which is a reflection of a slight slowdown in their economic push.
- Moderator** The next question is from the line of Punit Gulati from HSBC, please go ahead.
- Punit Gulati** Just wanted to understand for Gabon, has the financial closure been achieved?
- R. Mukundan** No, not yet.
- Punit Gulati** For the UK and Africa business, how long do you think will the operations take to come back to normalcy?
- R. Mukundan** In terms of UK, we are addressing the plan and it should probably be sometimes during this quarter. They should be back to normal in Soda Ash. In Salt they are already pretty much in

place. In terms of Kenya, their volumes are back up already, however as I said the only caution for Africa is that their exposure is almost 50% to India and 50% to South East Asia. The Indian market will see an impact of anti-dumping on the Kenyan product. So there will be a slight issue with the pricing as far as Indian market is concerned specific to Kenya while the market itself may not fall. As far as South East Asia is concerned there is a pressure in the market and any effort to increase prices is not going to happen. To summarize, in Kenya, while the volumes will be back, there will be a pressure on the margins.

**Punit Gulati**

Lastly, on the North American business, is there any scope for expansion of the Soda Ash capacity there?

**R. Mukundan**

The team is working on expansion and there is a project which they are undertaking where they are looking at several technology options to raise capacity to another 400,000 tons but nothing has been firmed up. Once it is firmed up during the course of next 3-4 months we will comment on it but the team is still working on the engineering design which has more or less been finalized. It was awarded to Jacobs a 6-7 months ago and we did announce that the work is ongoing and they are looking at three - four options of technology which has impact on both the capital which needs to be put in, and higher plant efficiencies.

**Moderator**

Next question from the line of Prakash Goel from ICICI Securities, please go-ahead.

**Prakash Goel**

In Q3 last year, we discussed the strategy of focusing on the core business and I would want to know in the last say 10-11 months, what were the incremental steps that we have taken, for example are we seeing limited visibility of Urea investment today in India and what are the crises that we are facing as a company in terms of like focusing on the core business, in terms of your strategy going forward if the India opportunity does not turn up?

**R. Mukundan**

As far as India opportunity is concerned we believe India is still a great market; Indian markets will continue to grow; it is a market in which we have a strong position in almost all our products. While Indian capacities in some places may not grow, Indian markets will grow, and to that extent we are gearing ourselves to feed the market. In Soda Ash, we believe the investments will happen overseas and these will increasingly feed the Indian market. At the current point of time we have to depend on our US production base to feed Indian market growth for Soda Ash until we settle the issues in Magadi especially with respect to energy for the pure ash plant. We now have some visibility on what we need to do to reduce the energy cost in pure ash plant, where we are in the final leg of finalizing the switch over to coal from liquid fuel and are going through all the issues related to supply chain because we never handled coal from the core to the plant and that is a new experience the team is going to go through. We are being extremely careful about finalizing



that switch over but certainly that will put that unit back on a stronger footing than what it is and it could also feed the Indian market growth.

As far as the Salt production is concerned, we have continued opportunities and options to extract more out of our existing salt fields and there are continuing opportunities to grow that business. We will continue to push that business ahead.

In terms of the Urea capacity, this the first quarter where we have had a successful run at the fully rated plant capacity post de-bottlenecking because our converter was hooked up in the last quarter. The plant has produced at a consistent rate very close to 3500 tons per day. At that time we had suggested that we would look at three - four options to move ahead beyond this point; one is of course the Brownfield expansion for which we are waiting for Urea policy. Secondly we would examine a Phase II of debottlenecking which does not need policy clarification and that will take capacity up by at least another 100,000 tons; . since our effort is to continue to push the domestic production to the maximum extent we can within the existing policy framework; and of course we are in interesting discussions with 2-3 other opportunities that have come up, both in Tripura where there is local gas availability as well; and we are working actively to ensure the progress of the overseas investments wherever we have partnered and finalized.

In terms of Phosphatic Fertilizers, we continue to maintain our position that fundamentally companies have to look for direct rock access if they want to make money. The current structure would yield only conversion margins which is anywhere in the region of \$50 to \$60 per ton. Anything beyond that would be very difficult to extract in the business with the current value chain proposition. We are being extremely cautious till we get access to the resource itself.

In terms of Potash we have invested in the Sulphate of potash mines in EPM where we hold 25% equity stake and that project has actually filed the 43-101; post that they have finished their pre-feasibility which has indicated that stable capacity of the plant would be about 350000 - 400,000 tonnes per annum. The Toronto Stock Exchange filing is available in the web site of EPM, On the Consumer side of the business we believe that the salt consumer franchise will continue to play a lead role in our overall consumer business. We are building our pulses business in a step by step manner and are being extremely measured in our move and we will continue to build that business at about 100% growth rate albeit from a lower base of 20,000 tons witnessed last year. Further, we will continue to build water business in the areas identified and will only build business in what we call as point of use water. We are not building our business beyond that point.

In terms of other new areas we have recently launched a slew of 'Flavored Salts' which is giving us the first experience in spices and at some point we will start to look at spices. Of course, pepper is the first entry we have done. Beyond pepper we are looking at various other spices through our new product development team which is coming out with product options. Hence the area of food additives and food related areas to consumer product looks very interesting for us. We will continue to build in the vacant spaces where the Indian consumer has been underserved.

As far as our Specialty Chemicals business is concerned we have grown both the contract manufacturing as well as our generics. In terms of contract manufacturing our capacity utilization, at Dahej is forging ahead and is as per the plan. As far as Generics is concerned in terms of the product portfolio, we continue to maintain brand strength. Out of the top 10 brands in India 7 brands belong to Rallis. Clearly, we continue to build brand portfolio in the Spec Chem business too. So overall if you look at the business we believe that Indian market is growing where it is easy to feed the domestic production and it is mainly in the area of Specialty Chemicals and Consumer Business. In the commodity area, while we have to look overseas for production base our focus on Indian market remains and we will continue to maintain our share and position in this market.

**Prakash Goel**

I have two more questions; one with regard to the Rallis, is there any opportunity to integrate the distribution system between Tata Chemicals and Rallis?

**R. Mukundan**

In terms of the market integration as well as the market structuring we have done whatever we could. If you look at Tata Chemicals our presence is mainly in North and East and clearly the strength of Rallis is the South and West, so that was very complementary in the move and we have done this without subjecting the business teams to the normal method of integration which is to say, can you reduce cost, our approach has been more to say can we move the revenues faster. If you look at the non-commodity business within Tata Chemicals that itself is close to- 500-odd Crores. We expect our non-commodity portfolio itself to grow beyond 1000 Crores, and Rallis would contribute equally to the growth momentum going forward in the non-commodity part of the firm. We are leveraging both these companies, and in addition to that we are also adding a layer of technology underneath for which we are working along with group companies like TCS and Tata Teleservices.

**Prakash Goel**

Would it be fair to understand that Rallis is already gaining from this particular liasoning with Tata Chemicals because of this integration or this benefit will come in future? I am talking from Rallis point of view. You explained Tata Chemicals point of view.

- R. Mukundan** For both companies we do a deep work in our territories together and both companies are benefiting.
- Prakash Goel** The point that I was coming from many of your competition today leverages the distribution strength of Urea and DAP or like PNK space, the chemicals in the pesticides and other agricultural input chain. We are just trying to understand as to when, what is the timeline?
- R. Mukundan** This issue which you talk about leveraging does not play well, in my view it is what we call as tagging; tagging one material with another. So when DAP was in short supply, DAP manufacturer is tagging every other product, today urea is in short supply, so every urea makers is tagging other products. Our way of working in this space is to work with farmers and not to rely on tagging. So while it is an opportunity, cross selling has not been our core approach going forward or even in the current market. We really tend to build with our relationship with the farmers with our relationship at the farm level to give us the market penetration.
- Prakash Goel** The last question is with regard to many of your competition has got very aggressive in the PNK trading and profited from that as well in the last three - four quarters whereas we have seen the Tata Chemicals is not being aggressive at all in that particular segment, any specific reason?
- R. Mukundan** We tend to maintain our position; we have neither been aggressive nor been coy about it. We have maintained steady pace. We tend to maintain risk and return on a very fair balance. The game of trading can also turn very much against you if the foreign exchange markets go against you or if market prices collapse in a short run. Sometimes it favors you, sometimes it does not. So our aggression is very measured in these things. We do not want to play beyond a certain point on trading and we do that to feed our core customers.
- Moderator** Thank you. The next question is from the line of Jasdeep Walia form Kotak Securities, Please go-ahead.
- Jasdeep Walia** In the current year a lot of credit has been extended in the market by all fertilizer companies which was not the case let us say last to last year. Would it be easy to withdraw this credit from the market when once the demand conditions normalize or would it take much more time than that because whichever company withdraws credit will lose market share?
- R. Mukundan** Actually you are responding to the previous question which was raised. That has been one of the reasons we have tended to stay away from trading. But we find even our position is not as good as what it used to be last year. So we are trying to tighten our belts even

further. We do not believe in credit sales and clearly it is a problem for industry, but less of a problem for Tata Chemicals but that does not mean it does not exist for us, it does exist. I think trade related losses are something which industry may get into if market prices and the market movement turn adverse

**Jasdeep Walia** Would it be able to withdraw this credit once the demand condition normalizes or it is going to be a very slow process?

**R. Mukundan** It is not a difficult issue for us because we are not overexposed. But for others I cannot speak for them. But, in general to withdraw credit overnight is always a difficult issue, because it is a very addictive process for the market, very difficult to be in the market away from addiction. It cannot happen with one player giving credit and another player not giving credit.

**Jasdeep Walia** Which I am viewing it will be very difficult to generate a consensus?

**R. Mukundan** It can happen very quickly if market demand accelerates. It is all a question if market demand continues to be soft it will be very difficult to remove that because every company will try to get rid of its stock. Today, industry is sitting on high level of stocks.

**P.K. Ghose** To answer your question I think it will be possible to withdraw the credit slowly over the next two - three months.

**Moderator** Next question is from the line of Prashant Parwadi from Axis Capital, please go ahead.

**Prashanth Parvadi** In this complex fertilizer space there is huge level of inventories that is currently building in. Just wanted to know your opinion whether we can see this inventory stock out over the next two to three months that is Rabi season, so what is your opinion on that?

**R. Mukundan** I think the efforts will be to take it out. We have very limited window to place the products in the market now. The placement window will close in another 2 to 3 weeks time. So I think the entire industry is working hard to make sure that we can do proper placement so that the stock position comes down. It is a tough situation industry is facing today.

**Moderator** Thank you. As there are no further questions at this time I would like to hand over the conference to Mr. Siddhartha Bhotika. Thank you. And over to you sir.

**Siddhartha Bhotika** Thank you Mr. Mukundan and thank you Mr. Ghose. Always a pleasure to have both of you here.

**Moderator**

Thank you. On behalf of Tata Securities Limited that concludes this conference call. Thank you for joining us.