SRF Limited
Q3 & 9M FY 2015 Conference Call
February 11, 2015

Moderator

Ladies and Gentlemen, Good Day and Welcome to the Q3FY15 Results Conference Call of SRF Limited hosted by Batlivala & Karani Securities. We have with us today Mr. Rajendra Prasad – President and CFO and Mr. Rahul Jain – Senior VP, Corporate Controller & Treasurer. 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. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Gaurav Jain from Batlivala & Karani Securities. Thank you. Over to you, sir.

Gaurav Jain

Thank you, Darryl. Good afternoon, everyone and thank you for joining us today. We would like to welcome the management of SRF Limited and thank them for giving us this opportunity to host this call. We have with us today, Mr. Rajendra Prasad – President & CFO and Mr. Rahul Jain – SeniorVP, Finance Controller & Treasurer of SRF with us.

I would like to now hand over the call to them for their opening remarks which will be followed by Q&A. Over to you, sir.

Rahul Jain

Good afternoon, everyone and thank you for joining on SRF Q3 and nine months FY15 results conference call. I have not been formally present on the SRF investor calls in the past, therefore as an introduction, I am Rahul Jain and I have been working with SRF Limited for the past six years; I head the Group Treasury and the Corporate Controllership function for SRF and report into our CFO Mr. Prasad. We will begin the call with brief opening remarks from Mr. Rajendra Prasad, following which we will have the forum open for an interactive Q&A session.

Before we begin this call, I would like to point out that some statements made in this call maybe forward-looking and a disclaimer to this effect has been included in the conference call invite sent out earlier.

I would now like to invite Mr. Prasad to make his opening remarks. Thank you.

Rajendra Prasad

Good afternoon, everybody, and thank you Darryl, Gaurav and Rahul and Welcome all of you who have joined the call till now on our quarterly call. I will begin the call by giving you a quick overview of the Financial and Operating Performance for the Quarter and the Nine-Months ended 31st December 2014, and then we will have the floor open for the Q&A session, I will be glad to address any queries that you may have.

Before I begin the overview, I thought I will share some views with you on the structure of the call. In the 10- 15 minutes or so that the overview takes, in the past I have usually spoken about the numbers and the changes over different periods. This quarter as well I intend doing the same. But my view is that this information is already available with you and all of you can do a better job than I of analyzing the changes. Hence, if you agree, which you can convey to Batlivala & Karani anytime later, from next time, I would like to cover the aspects of the Company which may or may not be clear and reflected in the numbers so that each of you who has been tracking the Company for some time has a better understanding of the Company's business; what we intend doing in the future, improvements that we are working on; what are the Company's strategies and so on. Numbers are an outcome of the strategies of the Company, its policies, execution efficiencies, and operational excellence. And this is what I would like to discuss in future with you rather than just the numbers. The opportunity to ask questions around the numbers on every subsequent call would be available to you in any case.

So now I will get to the conventional part of giving you the overview on the performance. We delivered steady performance in Q3FY2015 with our net sales marginally increasing to Rs. 870 crore from Rs. 859 crore in Q3 of the previous year in spite of reduction in commodity prices. Exports contributed 27% of revenues in Q3FY2015 as compared to 32% in corresponding quarter last year. EBITDA for the quarter improved 13% to Rs.169 crore from Rs.149 crore in Q3FY2014 leading to an EBITDA margin of 19% as against 17% CPLY. PAT for the quarter was stable at Rs.73 crore Vs Rs.72 crore in the corresponding quarter last year. Higher depreciation and interest expense due to capitalizations done in March 2014 impacted overall profitability during the quarter.

In nine-months 2015, net sales were higher at Rs. 2,723 crore from Rs. 2,518 crore of the previous year. Exports contributed 27% of revenues in the nine months' period as against 30% in the nine months' period of the previous year. EBITDA for the first nine-months increased by 32% from Rs. 425 crore to Rs. 562 crore in the nine months' period of the previous year, leading to a margin of 20.6% as against 16.8% CPLY. PAT grew by 52% to Rs. 249 crore as against Rs. 164 crore in the corresponding period last year.

I am happy to report that the Board has approved an interim dividend of Rs. 5 per share which translates to a payout of 12% on nine-months PAT, including the interim dividend that was declared in July, the payout ratio to nine months' PAT is about 24%.

The Board in its meeting also approved CAPEX of approximately Rs. 25 crore for enhancing the R&D capability of the Chemicals business for faster turnaround of customer request. In addition, CAPEX of Rs. 66 crore for modernization of Technical Textiles Plant at Gwalior was approved.

Let me now give you a quick update on each of our three business segments: In the Chemicals and Polymers segment we delivered healthy performance in the Refrigerants and Specialty Chemicals business. In Q3FY2015 revenues from this segment grew by 14% year-on-year at Rs. 307 crore as compared to Rs. 270 crore in Q3 of the previous year. The segment now contributes 35% to overall revenues as against 31% in the corresponding period. Operating profits for the quarter were higher by 7% at Rs. 75 crore versus Rs. 70 crore in Q3'14.

I am sure all of you would be curious to learn about the acquisition we have recently made from DuPont. I am happy to share here that SRF recently acquired DuPont's Global HFC 134a Regulated Medical Pharmaceutical

Propellant business. With this acquisition, we have become the only Indian supplier, and one of three global suppliers of HFC 134a Pharma Grade. As per the deal, we will own DuPont's Dymel® brand and also receive the technology and knowhow for setting up our own facility for manufacturing the product – HFC 134a Pharma Grade. We plan to add the additional equipment required to manufacture HFC 134a P, that is how it is referred to, at Dahej. In our estimate, and as advised by DuPont, these additions can be done with minimal CAPEX. Under the agreement, till our facility is upgraded to meet pharma standards and the product approved by our customers, DuPont will continue to supply SRF with their product. With this phased transition, our product too will be manufactured with DuPont knowhow and technology; the customer would experience the same product quality during and post transition. This acquisition is in line with our strategy to further move up the value chain and has enabled us to enter the niche higher margin Pharma Product segment. DuPont currently has a market share of around 15% globally. We believe with our focused approach to drive this business we can gain, A) higher market share and B) participate in the strong growth witnessed globally in the use of these products in Metered Dose Inhalers. I can explain in detail in case people wish to know during the Q&A session as to what Metered Dose Inhalers are.

SRF acquired the business at an attractive valuation of $20 million. While incremental revenues from the business are nominal in relation to the size of our Chemicals business now, but the acquisition adds to our profitability. Also, the business brings substantial strategic gains to SRF as it enters the Pharma domain directly. The purchase consideration is to be paid in tranches which makes the acquisition self-funding to some extent. Most importantly, this transaction with the global and respected Chemicals Company like DuPont, reflects the status SRF enjoys in international arena, where DuPont had the confidence to hand over its existing business to SRF as a successor. This speaks volume of how our competitors perceive us.

The Specialty Chemicals segment continues to deliver healthy performance. Over the last five years, we have delivered strong growth and we have spoken about this division in the past., and we have made and continue to make adequate investments to maintain the growth momentum over the coming years. We have invested and capitalized around Rs. 1,350 crore till date to develop 130 acres out of the 300-odd acres at the Dahej facility and the capital work-in progress at Dahej is about Rs. 270 crore, either from previous remaining CAPEX or those CAPEX amounting to Rs. 253 which we have approved earlier this year. This site will help produce multiple products with focus on Fluoro Chemicals and Specialty Chemicals. As earlier mentioned, we plan to invest around Rs. 250 crore to Rs.300 crore every year on an ongoing basis in this business primarily at Dahej.

At this point, I would like to dwell a little on the new CAPEX approved in the board meeting yesterday: Rs. 66 crore approved for modernization of Technical Textiles Plant at Gwalior is in line with our earlier communication that we would continue to incur CAPEX for Technical Textiles for modernization and technical up gradations which are necessary to ensure continued, stable and good quality cash flows from this business. The other CAPEX of Rs. 25 crore for R&D equipment is of special significance. This expense would greatly enhance our start to finish capability for product development. This would enhance the capability at all stages of the product development cycle, in research, development, design, execution and stabilization. We expect that once these equipment are in place, the throughput of the R&D and design team for the products developed and commercialized by the team would increase substantially. This could be a game changer in our ability to add Specialty products to our portfolio.

Coming to the Technical Textiles business, during the quarter, revenues from this business were lower at Rs. 418 crore as compared to Rs. 446 crore in Q3FY2014; however, operating profits were higher by 8% at Rs. 41 crore versus Rs. 39 crore in Q3 of the previous year owing to better margins. This was primarily due to other products which are included in Technical Textiles business. Nylon Cord Fabrics, the largest contributor to this segment, reported stable volumes. This business witnessed marginally low margins on account of higher costs of carried forward raw material inventory. In this business, changes in the raw material costs are passed through to the customers, albeit with a little bit of time lag. So volatility in raw material prices normally has minimal impact on the overall performance over a period. Overall, the business is a free cash flow generating business with healthy contribution to our performance.

Moving onto the Packaging Films business, revenues from the segment increased by 8% year-on-year to Rs. 159 crore from Rs. 148 crore in Q3FY2014. The operating profit was higher at Rs.7 crore as compared to loss of Rs. 7 lakh in Q3 of the previous year. As compared to the second quarter results, we reported lower profitability as the performance was adversely impacted by the sharp correction in commodity prices. Some of this impact will also be experienced in the coming quarter as well. However, the domestic business cycle is expected to bottom out soon, and we are hopeful of an improved performance from this segment from a medium-term perspective.

To conclude, we are moving in the right direction to consolidate our leadership position in most of our business segments. Our unique R&D strengths will help us continue to focus on high quality Specialty Chemicals and developing adjacent businesses. In this regard, the recent acquisition highlights our keenness on further building our knowledge base and capabilities for carrying out research in the field of Fluorine molecules.

On that note I conclude my remarks and would like to thank you all for joining us on today's conference call. We would now be happy to discuss any questions, comments, or suggestions that you may have.

Moderator
Thank you very much. We will now begin the question-and-answer session. Our first question is from the line of Dixit Mittal from Subhkam Ventures. Please go ahead.

Dixit Mittal
Sir, can you give an idea of the market size of the Pharma Grade HFC and what is the growth rate that it has been growing at?

Rajendra Prasad
The growth rate of this is about 6% to 8%. Now I will tell you where it is used and for the benefit of others on the call who may not be familiar with this product. This product is used in what we commonly know as Asthma Inhalers, the puffs which asthma patients take when they face breathing problems. So this product is the propellant which actually pushes the drug out in the form of gas and which the patient inhales. So the expected growth rate is 6% to 8%, but in certain countries it may be higher as the pollution increases and air quality deteriorates and increases the lung problems. So the growth rate is 6% to 8%, the market size is about 8,000 tonnes globally.

Dixit Mittal

Sir, in terms of dollars, if you can indicate the price?

Rajendra Prasad

This product can sell anything between $8 to $10 per kilo which translates to around $80 million plus.

Dixit Mittal

The margins in this business are comparable to Specialty business or HFC business only?

Rajendra Prasad

If I was to evaluate only the incremental margins because we already make HFC 134a, so incremental margin could match with Specialty Chemicals but if you were to take the margins of HFC 134a because the pharma grade earns a markup on HFC 134a, the margins will match Specialty Chemicals. Because HFC 134a itself has lower margins, overall margins will not match Specialty Chemicals.

Dixit Mittal

Secondly, how has the quarter been for your Thailand and South African subsidiaries?

Rajendra Prasad

Thailand is very good, I am happy to say like we had earlier indicated, as of nine months and quarter; both units are EBIT and EBITDA positive. One thing that you all already appreciate is that this is actually the first complete year of both these plants.

Dixit Mittal

South Africa also is making profits in three months?

Rajendra Prasad

Yes, both plants for Q3 and nine-months are EBITDA and EBIT positive.

Dixit Mittal

Can you say how much is the capital employed in Specialty at the end of December out of your total Chemicals division is around Rs. 2,200 crore?

Rajendra Prasad

We will come back to you on this.

Moderator

Thank you. Our next question is from the line of Rakshit Kachhal from India Ratings. Please go ahead.

Rakshit Kachhal

Just a quick question on this DuPont acquisition. So, we already have 12,000 tonnes of capacity in HFC. So, when we say we are going to go for a Pharma Grade, we are adding new capacity or we will convert some of that capacity that we already have in Dahej plant?

Rajendra Prasad

We will not add new capacity. The processing to get this product is only a downstream process after HFC 134a is made. So let me clarify also that it is exactly the same molecules as used in the Refrigerants Gas, except that you purify it further to make it Pharma Grade. So it is this purification that you actually need to add. So, in fact it provides a consumption avenue for the 12,000 tonnes that we are making.

Rakshit Kachhal

When we say minimum CAPEX, can we put some number to it?

Rajendra Prasad

It is in single-digit US dollars, maybe $5 million maximum, actually it is Rs.20 to 25 crore for the additional equipment.

Rakshit Kachhal

Sir, moving up the value chain in the Pharma with this DuPont acquisition that we have done, because I believe DuPont is not serving a very large market size, so, do we see growth in market for us when we get into this business or like how do we plan to grow in this business?

Rajendra Prasad

Actually the purpose of acquiring was that DuPont was not occupying the space that it should. For DuPont this was a relatively very small business compared to DuPont’s size. So it was losing focus and they were actually not devoting enough attention or manpower to it. If we are to devote manpower to it, naturally it can increase our share of the pie. So the pie will increase at its growth rate in any case, but we expect to increase our share of the pie by devoting greater attention. One particular manufacturer in India occupies global position in these kinds of asthma inhalers. So there are two-three things which are happening in the environment which will make Indian manufacturers position a little better. Naturally if it is an Indian manufacturer and we are making this HFC 134aP in India we will have a better position to be able to sell our goods.

Rakshit Kachhal

In the HFC Pharma Grade only, is this move also driven to some extent due to the anti-dumping duty case being delayed or rather any positive sign coming in and we might not be able to push the kind of volumes you are expecting in US market?

Rajendra Prasad

I do not think it was a direct result of the anti-dumping not coming. Even if anti-dumping had come I think if this opportunity came we would have still done it. The reason being that it only adds to it (to utilizing our HFC 134a). The real reason here like I have mentioned is that we get the experience of the pharma industry as to what all is required to be a participant and supplier of Specialty Chemicals to the pharma industry. This requires a different kind of rigor, it requires a different kind of regulatory compliance, so this gives a good entry point for us. And other thing is that HFC 134a as it is, is not marked for phase out; it is marked for phase down. And in pharma gas in that HFC 134aP is not expected to even the phase down because it occupies such a small space of overall HFC 134a that it may continue to be a propellant for years to come even when HFC 134a has been phased down, this may not even face a phase down. So this actually gives us longevity of the product.

Moderator
Thank you. Our next question is from the line of Manish Mathur from Firstrand Bank. Please go ahead.

Manish Mathur
On the acquisition, am I right in assuming that there is no incremental debt that is being taken to fund this acquisition?

Rajendra Prasad
As of now there is no debt. We did not fund this immediately. (The amount) that we have paid out, it is not from any debt source. We had enough liquid funds to pay for it. We paid $10 million when the deal was done, and for the balance $10 million the requirement will have to integrate with the rest of our borrowing plan, and based on that we will decide whether we are borrowing more for it or not, because the payment for this is on a deferred basis over five years. So, whatever the liability arises will not actually compel us to make a decision that I need to fund annual payout through debt. If other requirements are there then it will be added to that. As regards the present payment that we have made of $10 million, that has not been funded by debt at present.

Manish Mathur
So on a consolidated basis what is your total debt and EBITDA number look like?

Rajendra Prasad
Very good question. EBITDA I will not give a guidance, and consolidated debt would look like about Rs. 2,300 crore, and if there is any cash element about Rs.100 crore odd would be cash lying at various places; so (net debt) it would be approximately Rs. 2200 crore. Manish I do not know whether you have been on calls earlier, I presume you have, but we have been saying that the March balance sheet should actually see our debt hitting its highest point, and the difference between the debts of March '15 and March '14 should be in the region of Rs. 100-150 crore , the increase despite putting in capital in Dahej, etc.

Manish Mathur
On the South Africa Packaging Films business, the sales are they primarily now domestic in nature, or are they more catering to exports?

Rajendra Prasad
When we started they were more biased towards exports because the local buyers were still arranging the supply chains to accept our sales because they already had long lead times and they had orders which were in the pipeline. Over a period we have been switching them over to taking their needs from us, and let us say from our point of view I have to maximize domestic sales first and then sell overseas. So this is a transition which is

happening gradually. You will see that the needle is shifting towards domestic sales because it is better for us to sell domestically. So right now our domestic sale should be in the region of 75% odd - on an accumulated basis. It is right now, in a sense, work in progress.

Manish Mathur

Just on follow up on that, do you see any prospects for expansion in terms of CAPEX if you see a market opportunity there or that is not there at present?

Rajendra Prasad

While we have, let us say the infrastructure is capable of accepting additional lines, at present we do not foresee any expansion happening in the near future.

Moderator

Thank you. Our next question is from the line Yatin Mehta. Please go ahead.

Yatin Mehta

We have KAMA Holdings and SRF Limited, right? If I look at KAMA Holdings, it is just an investment Company for SRF and sort of does not serve any other purpose. So why do we hold two different companies as of now?

Rajendra Prasad

That is the holding structure. Many times you have holding companies, subsidiary companies and operating companies and that is the way the promoters have held the structure, what is there to comment. Both are listed companies, promoters holds about 74% share in KAMA, so that is it.

Moderator

Thank you. Our next question is from the line of Chintan Modi from Reliance Securities. Please go ahead.

Chintan Modi

Sir, wanted to understand about the growth rate of Chemicals business in this quarter which came in at 13.6%. So if you can share some more color to it especially the growth in the Specialty Chemicals business for the quarter?

Rajendra Prasad

It is a very good question, Chintan, because otherwise you do not get a flavor of the divide between Specialty Chemicals business and the Fluoro Chemicals business. I will, in a sense, extend my answer much beyond what you are asking so that people get a better understanding. We have always been saying that the Specialty Chemicals business over the last 4-5-years has grown by 50% per annum. This is a statement which is a matter of fact and can be confirmed, and we have also been saying that the Specialty Chemicals business is a lumpy business because lot depends on the customers' campaign and requirement as per customers' campaign. So it actually requires us to produce the customers requirement over a period of time so that I can do my production planning, and at times even inventorise that material before I sell it to him. Because he only needs it at a particular time, I need to start making it may be 3-months before that or 4-months before that. So, this is another statement of fact. Generally, analysts have a tendency to compare one Q2 with Q3 and the other they compare is

Q2, Q3 of last year with Q3 of this year. Q3 of last year was an exceptionally high quarter which even the other numbers of Q1, Q2, Q3, and Q4, if you compare Q3 '13 was very high. So this Q3 of FY14 is higher than the Q3 of last year but not as high as people expect. But at the same time if you take the 9-months of last year and 9-months of this year it (growth) matches. So, what I am trying to emphasize is that Specialty Chemicals business does not offer itself for quarter-on-quarter trending.

Now having explained the Specialty Chemicals piece what I want to highlight that the Fluoro Chemicals business has done much better than Q3 last year and much better meaning in revenues and in profitability. We have been saying that Fluoro Chemicals business is a steady state stabilized business, and if you see some things happening in a steady state stabilized business, it means that some structural change is taking place. So I am very happy this time that Fluoro Chemicals has shown growth as year-on-year and quarter-on-quarter comparisons as compared to Specialty Chemicals which has shown lower growth which we know is a lumpy business and which we know will grow in normal course.

So this time you might see a little decline in profitability of Chemicals business as a whole because the sales mix has changed, and the sales mix has changed by increase in conventional Fluoro Chemicals business which is a very positive sign for us. Now that has happened because with certain changes the business was working on over the last 1 year are slowly coming to bear fruit. Now, whether the increase will be every quarter and increase over the previous quarter, I cannot say but what may happen is that the stabilized level may become higher. So this is one quarter where Specialty Chemicals has not shown as much growth over last year as Fluoro Chemicals has. Overall Chemicals business blended margin may look lower. This is what has actually happened in the Chemicals business as a whole domain.

Chintan Modi

Secondly sir I was looking at Q4 FY14 numbers wherein I have seen that the Chemicals business margins have shown a sharp decline. So any kind of seasonality is attached to this business in the Q4? The PBIT margins had come at around 13.8% which was low compared to the average that we are doing of 24%.

Rajendra Prasad

Because Chemicals business what has happened in March'14 whole lot of CAPEX got capitalized which was for Specialty Chemicals business, so as a result the sales mix is gradually changing in favor of Specialty Chemicals. So over a period of time you will see a marked difference in combined profitability. The profile of profitability of both these businesses is different. Slowly the denominator is growing in any case, but the growth in denominator is coming from Specialty Chemicals on an ongoing basis, because Fluoro Chemicals business is like I mentioned is a stable and conventional business. Actually, profitability, over a period, I should think you should keep seeing an increase as we keep capitalizing Specialty Chemicals plants.

Chintan Modi

With respect to the Dymel acquisition, since we have got an access to the DuPont's pharma customers with respect to HFC134aP, does that create a possibility in future to cross sell our Specialty Chemicals business to them also?

Rajendra Prasad

Yes, it is a good question and it is actually obvious, one of the reasons was that we should start dealing with pharma customers, and once we start dealing with globals in pharma business, we are sure we will find opportunities in our Specialty Chemicals products to be able to sell to them, and some of them may require pharma or cGMP protocol; maybe even before the cGMP protocol that I am selling to them before they become active ingredients. So there are a host of opportunities and maybe those products we are not making today but if they have a requirement I have the ability to make. So it is not just that today's products whether I can sell to them, the question is "Can I develop products specially to sell to them?" So the point is that door will open. And that is one of the strategic gains that I alluded to earlier.

Chintan Modi

With respect to the tax rates, if you can give us some kind of guidance sir like for 9-months also we have done like 23%?

Rajendra Prasad

Even when we were doing the tax calculation for this quarter, there are so many moving parts that it cannot be finalized till it is actually finalized. The reason being that a lot depends on what I am going to capitalize during the year. So my estimate of future profits for the year ending depends on how much capitalization I will put on the books. And based on that I can compute whether investment allowance will be available to me or not. So there are quite a few variables. Based on the assumption that I should capitalize some more assets in Dahej. I think the rate should remain approximately the same, because this includes certain assumptions on capitalization of assets in Dahej, because that changes the depreciation and it changes the investment allowance eligibility. So it is based on that assumption.

Moderator

Thank you. Our next question is from the line of Sabyasachi Paul from Credit Research. Please go ahead.

Sabyasachi Paul

Sir, my question is regarding this CAPEX in Technical Textiles. Is there a capacity expansion or is it NTCF or Belting Fabrics?

Rajendra Prasad

Thank you and it was a question. In a sense I was waiting for it, because I expected that people would question our investment in Technical Textiles. I have been mentioning on the previous calls that Technical Textiles gives a whole lot of pretty much assured cash flow every year, and the cash flow can range between Rs.200 crore to Rs.250 crore. Now to maintain this cash flow, you need to continuously make improvement so that this cash flow is not jeopardized. I had also said that we will continue to make upgradation, modernization, balancing equipment and rationalization investments in this business even though we will not do high quantum CAPEX which will increase production capacity or which comes out of the blue. So this is the background. To answer your specific question, this expansion is on replacing our existing twisters. All our equipment is now aging and newer technologies have come into place. So what this is going to do is it might increase throughput or capacity marginally, but the main reason for making this investment is quality, so that we continue to retain our customers and compete with our competitors on quality which might lead to better realizations and which will most importantly contribute heavily in sustainability of cash flows. Because if you are not able to compete on quality, over a period, your cash flow will go away, as you cannot take a cash flow for granted till you work on it. And the other thing is because quality and the reliability of process will increase, the cost of conversion will go down. So naturally like I mentioned it might improve margins as well. So let me tell you that other than that it is a strategic investment because I need to be in this business, I need to protect my cash flows, it is a ROI investment on its own merits. So it is not that I am putting in this investment in a low yielding investment; it meets its own WACC requirements, its meets its IRR returns, and it provides me sustainability of cash flows. This is what I said earlier also that we will invest Rs.25 crore to Rs.50 crore out of that Rs.200 crore the business makes, we will keep putting it back just to make sure that the next Rs.250 crore comes.

Sabyasachi Paul
And just one more on this Technical Textiles, we have seen a sharp softening of raw material prices. So is this largely a pass-through or would you really benefit from this maybe?

Rajendra Prasad
No, we would not benefit from it, and it is largely a pass-through but with a time lag. Time lag because ours is a conversion business, especially NTCF. So the way the formulas by and large work is cost of Caprolactam plus conversion margin plus some extra on top of it and that gets fixed. So it will be a time lag issue but not that over a long period of time we will make money or we will lose money because it can work both ways. So right now it is decreasing Caprolactam prices, tomorrow it could be increasing Caprolactam prices.

Sabyasachi Paul
So this lag is generally about maybe 2-months, 3-months?

Rajendra Prasad
No it is less than that because a lot depends on how much inventory you hold and how many orders in advance you hold, so if you hold let's say 45 days inventory and you hold committed orders also for 15-days, so the net exposure is only 30-days. It depends on that. Plus in this particular case Caprolactam even though it is import parity kind of pricing but the time the inventory holding changes if you buy domestic or overseas. So if you change your mix of procurement, your inventory levels may undergo a change not on pricing, because pricing is generally import parity. So the local supplier will give you faster, so you need to hold less, and overseas supplier because of the high fees and the trans-shipment etc., you need to hold more.

Sabyasachi Paul
And for you then what percentage of the Caprolactam could we import?

Rajendra Prasad
Today, I think it would be about 40% import, 60% domestic, but at times there is unreliability in the domestic market. They (domestic supplier) wants to take a shutdown, and there is only one supplier in India GSFC.

Moderator

Thank you. Our next question is from the line of Rohit Nagraj from Sunidhi Securities. Please go ahead.

Rohit Nagraj

Sir, could you give some more understanding on how the new product development on the Fluoro Specialty Chemicals is happening, any new products which are in pipeline and which have got good potential in terms of incremental revenues and obviously margins? And have we cracked any new products for the global customers like Syngenta, Bayer, etc.?

Rajendra Prasad

Okay, thanks a lot, Rohit, for your question and I think it is very good one. I will preface it with the new CAPEX that we have put in and then the whole group will understand how the development takes place. Either we approach or we are approached by the customers to develop a new product for them, a new molecule which they will use in their products, which let us say gets put in a funnel. In a funnel we would be having something like 50-odd-molecules to work on, some of the molecules will be something that we think customers will require and we should develop it before we approach them. And as we work on them, some of them look more promising than others, and some of them which are as it is customer-driven we go back and tell the customer that we developed this for you, and we produce some lab scale product and show it to them and they test it and it goes to the pilot plant, and from pilot plant it goes to a flexible manufacturing plant.

Our intention is that out of these 50, at least 3 to 4 of them should go to the dedicated plant and at least 7-8 should make it to the flexible manufacturing plant. So, if we can convert a funnel of 50 to 7 of flexible manufacturing, of which 3 or 4 into dedicated plants, I have been very successful. Dedicated means that I have a plant which makes only that product for that customer and I have defined orders. That is the highest level of certainty. Now in the new CAPEX that we have put what it actually does is it attacks our product development cycle in the research stage. It helps you do that research faster because these are actually a test bed of multiple reactors which are miniature, in a sense small reactors, you could actually run, test reactions simultaneously on 7-8 reactors changing the operating parameters. So you could say that in one I run (the reation) at higher temperature, low pressure, in one I have a different catalyst, in the third I have higher pressure, lower temperature and so on. So by capturing the operating parameters, I can come out to optimized production formula. This cuts down my research and development piece. This also tells me which kind of a reactor should be used, so it cuts down my design time. And then part of the CAPEX attacks the pilot plant where we are reconfiguring the pilot plant where the switch over from one piloting to another piloting period is shortened. We are reconfiguring it by putting additional reactors making it more modular, so you do not have to shift equipment from one to the other just because you are trying to pilot a different product. Because what happens, if the downtime is high, the entire range of products in sequence get delayed. Also, because of the first piece I might not require piloting for some products in the first place, it may go directly from this test bench into production, some which require piloting or the quantities required are so small, I do through piloting, and I make the pilot plant more adaptable to quick changes. This is what the CAPEX covers. I get a better design, I get a better material of construction and better operating parameters. So what happens is my execution of the project is faster plus the stabilization period is reduced. Earlier, what used to happen it is in real-time I start finding defects and I have R&M at that point of time. Then the plant needs to be brought down because I need to change things to stabilize the plant. All that will happen upstream rather than happening downstream. So what will happen is it will increase the throughput of what goes through R&D up to production much faster.

Rohit Nagraj

How much time is expected for putting up this particular R&D facility for which we are spending?

Rajendra Prasad

I think this should be done in next 6-months according to the CAPEX which has been approved because they are actually two CAPEX; one reflects the test bed configuration in a sense and a little bit of lab equipment, and the other reflects the changes to the pilot plant. So there are two sets but both are in the same sequence. So what I used to take 18-months to set up a plant, there's a band, stabilize it, might take me much less to set up and stabilize and releasing these two pieces of equipment for doing something else.

Rohit Nagraj

How much time does it take for a product for an approval or a validation of a process?

Rajendra Prasad

It depends on the product because the Specialty Chemicals that we make, one product may undergo five reactions, other may undergo seven reactions, if I have already done five and I am selling that product someone who asks me for the another product which has seven, but it is downstream of the same one I need to develop only two more reactions, it becomes much faster. But if someone gives me a product where I have to start from ab initio it would take longer. So this is the other piece which our group needs to appreciate that with every success my experience grows and my ability to make the next product is faster because of the variety I already hold, the inventory of knowledge and the inventory of equipment that I hold, because of that I can make something else.

Rohit Nagraj

If my understanding is correct, so the way you talked about funnel of 50 products with this new R&D facility we will have an increase size of that funnel?

Rajendra Prasad

We will have increased capability to process the funnel.

Rohit Nagraj

So we will have timelines which will get shrunk, so the process will be faster?

Rajendra Prasad

Yes. **Speed to** market changes. It means during 365 days I can put in more products through the same pipeline, that is the thing, and both these CAPEX are in sequence, so they are actually striking at two different capabilities.

Moderator

Thank you. Our next question is from the line of Chetan Thacker from Emkay Global. Please go ahead.

Chetan Thacker

Have we finalized on the CAPEX for FY-'16 and the breakup of that how much will go where largely?

Rajendra Prasad

Actually, it is pretty much in public space and repeatedly we have said. One is that I will continue to grow in adjacent businesses, which is the motherhood statement, the other is that we will invest in Dahej because Dahej is still a site which is not fully exploited yet, the third is that we will continue to invest Rs.250 crore to Rs.300 crore every year in Dahej, most of it will come in Specialty Chemicals. Some of it may come in infrastructure because this is a 300-acre site which we have developed about 130-acres so which we are today close to exhausting, now I need to go to the next phase and build some infrastructure there; some of the infrastructure will suffice, let us say power plant 17.5 MW, so it has still capacity to run the next phase, similarly, affluent treatment plant. So these infrastructures of canteen or employee facilities, etc., these already exist.

So the CAPEX of Rs.250 crore to Rs.300 crore will mainly come in Specialty Chemicals, maybe in Fluoro Chemicals and something in infrastructure but at Dahej. So this is one. Other is continuous like improvement CAPEX is like we have just now done for Technical Textiles these will not be big; they will be within Rs.50 crore to Rs.70 crore and all which we can meet out of our cash flows. Then the third category actually is something like the DuPont acquisition which came out of the blue and it is something that we could not ignore. So there could be those opportunities, but on a steady state or running state, the CAPEX that I see is basically in Chemicals business and in modernization or upgradation of technology for maintenance of cash flows in other businesses. Today, we do not foresee any investments in other businesses of putting additional capacity.

Chetan Thacker

Second is the utilization of Thailand and South African plants. What would be the utilization rate for nine-months and the quarter?

Rajendra Prasad

The quarter would be about 100% in Thailand and about 80% odd in South Africa, and South Africa you have got to in a sense temper it a little bit because South African economy goes on a holiday around Christmas. Close to 15 days of that month, production stops, everything goes off, and it is not only with our industry, it happens across the economy, And that holiday extends to first or second week of January. So part of that quarter has to be factored in October-December quarter. So that is why it cannot ever be 100% because you will have to reduce your available capacity also, but they both are doing well. Thailand is doing extremely well. Just for information of everybody so that you recognize and understand the business, Thailand does not keep too much of raw materials of Polyester Chips, it has two or three days of chips because the sourcing is from close buy and the sourcing contracts are like that. So the impact of crashing crude has very little impact on Thailand, because whatever they were buying they were selling, so it is like daily wage earner, whatever he earns, he eats. So a very little or negligible impact. So we are doing pretty well actually.

Chetan Thacker

All businesses put together because of fall in commodity prices what would have been the extent of loss that would have happened because of inventory which is already there?

Rajendra Prasad

Actually, difficult to compute because what was happening is crude prices are falling across and some products, let us say, Caprolactam, we barely hold domestic stock, we must be holding for less than 30-days and imported we must be holding about 45-days. So the blended one would be around 30-32 days actually. I do not know people are aware that raw material inventory does not need to get mark-down under certain conditions. So the effect of raw material flows through trading cycle. What actually happens is you are invoicing lower because the prices have fallen but you are holding higher cost stock, your margins will shrink. So it appears in the margins that you see, unlike finished goods where it appears there is a mark-down of inventory. It gets very difficult to compute the effect of such raw material decline, where the decline is happening continuously for four months, that is the point. How much of it was actual reduction in sale price? How much of it came due to the raw material becomes difficult to distinguish.

Let me again clarify, that let us say in November I am holding 90-days stock, so in January I am still holding part of that stock. I sold (finished stock) in November, I sold in December, but I am still holding 30-days of part expensive stock, so in January my margin will get hit because the inputs cost is higher, but after January, it will adjust itself until raw material falls further. Now what has happened? Crude has changed direction, now is the time to pick up. That is where we are.

Moderator

Thank you. The next question is from the line of Avinash Agarwal from Sundaram Mutual Fund. Please go ahead.

Avinash Agarwal

Just wanted to understand this plant addition that we have to do for HFC 134aP. How much time would it take?

Rajendra Prasad

Very good question. Now, actually, the setting up time is within a year, but because it is a pharma product, it has to undergo certain stabilization test, etc., which are mandatory. So even after you make the product, you cannot sell. They have to undergo those tests and you cannot crash that time. So we expect that the benefit of our product will come after two years, which will increase margin further, because right now, you got to see the sequence, it is HFC 134a gets refined into HFC 134aP,. So right now I am buying the final product from DuPont. So DuPont has its own margins built into the production of HFC 134a itself and in further refining. Once I set up my own plant I will use my own HFc 134a. End-to-end margin if at all should be higher quantitatively in amount, but that would happen after two years.

Avinash Agarwal

Just to understand the pricing of HFC 134aP is it usually very stable, are these long-term contracts?

Rajendra Prasad

Because demand is going up and suppliers are only three in the world and other thing is new suppliers are difficult because of two reasons – you have to have HFC 134a as a raw material, raw material of HFC 134a suppliers are limited, and then you got to have the technology to refine it. So it is stable, but it is a market.

Avinash Agarwal

Who are the other two suppliers other than DuPont?

Rajendra Prasad

One is Mexichem and other is Solvay; Mexichem is the biggest, there is no longer DuPont now, SRF is the next and Solvay is the third who have sold their business to Daikin I understand.

Avinash Agarwal

Could you also touch upon the Coated and Laminated business, how are they doing, any improvement seen there?

Rajendra Prasad

There is improvement as compared to previous quarter, still to come up to speed as per expectations.

Moderator

Thank you. Ladies and Gentlemen, due to time constraints, that was the last question. I now hand the conference over back to Mr. Gaurav Jain. Thank you. And over to you, sir.

Gaurav Jain

Thank you, Darryl. We thank all the participants and management for patiently answering all the questions, thank you everyone, thank you Mr. Prasad and Mr. Jain

Rajendra Prasad

Thank you everyone for joining in and spending time with us on the call, good bye.

Moderator

Thank you very much. On behalf of Batlivala & Karani Securities that concludes this conference call. Thank you for joining us and you may now disconnect your lines.

Note:

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