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25th May, 2015

SRF/SEC-D/16

Transcript- Earnings Call (Audited Annual Financial Results for the FY 2014-15)

In continuation of our letter dated 12th May, 2015 sending you Investors presentation for the above mentioned earning call , please find enclosed transcript of the same for your reference and record.

Thanking you,

Yours faithfully,
For SRF Limited

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SRF Limited
Q4 & FY 2015 Conference Call
May 12, 2015

Moderator:

Ladies and gentlemen, good day and welcome to the SRF Limited Q4 FY15 Earnings Conference Call hosted by Ambit Capital. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask question at the end of today's presentation. Should you need assistance during the conference call please signal an operator by pressing '*' then '0' on your touchtone phone. I now hand the conference over to Mr. Ritesh Gupta of Ambit Capital. Thank you and over to you sir.

Ritesh Gupta:

Thanks for logging in. We have on the line with us Mr. Rajendra Prasad – CFO, SRF Limited; Mr. Mukund Trivedy — Head of Corporate Communications; and Mr. Rahul Jain — Controller & Treasurer, SRF Limited, to discuss the 4Q FY15 and FY15 Results. Now, I will hand over the call to Mr. Mukund for opening remarks.

Mukund Trivedy:

Good afternoon everyone and thank you for joining us on SRF Limited's Q4 and FY 2015 Results Conference Call. We will begin this call with brief opening remarks from our CFO, Mr. Rajendra Prasad, following which we will have the forum open for an interactive question-and-answer session.

Before we begin this call I would like to point out that some statements made in this call may be 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.

Rajendra Prasad:

Good afternoon. Like I mentioned last time, I would take actually no time on the analysis of the numbers as far as going up and going down and percentages and the degree of change are concerned in this call. What I will focus on for a very brief period are the significant events that have taken place during the quarter and the significant events that have taken place during the year, which could have had an impact on the results.

When we discuss quarterly results it will be on a standalone basis and on an annual basis we will discuss consolidated results . So keeping that in the background, I would like to in the beginning give your quick update on the business as a whole for SRF and then on our business segments.

Overall, the Company has performed well and as per our expectations. Other than the usual market variations there were certain unexpected events that are detailed in the explanations. All businesses generally maintained the trend.

First, I would like to cover the quarterly results followed by the full year results. During the quarter the significant events that impacted results were as follows**:** The reduction in crude based commodities which form substantial part of our raw materials, reduced the revenue across the board, especially during the third and fourth quarters. This reduction had two impacts — one was on the profit & loss account, which was in the form of losses on account of inventories held by SRF of higher priced raw material, work-in progress and finished goods; the other impact was that the revenue numbers were lower as the whole slab moved down. So even when we started buying lower price raw material, the revenue also was correspondingly lower, even though there was no loss attached to it from that point onwards. During the quarter, partial impact of low crude prices was felt mainly in two businesses — Technical Textiles and Packaging Films; and in Packaging Films mainly in the domestic business till about mid-February. This was about Rs.10 crore and Rs.6 crore respectively.

During the quarter revenue from Dymel deal, this is the acquisition of our 134a Pharma Business from DuPont, which was completed on 31st December 2014, started to flow into the Chemical and Polymer business. However, the revenues recorded as sales and other income were partially offset by expenses incurred on the acquisition, which we did not capitalize and the depreciation on the acquired assets. In spite of the one-time crude price lead losses, margins showed improvement.

The annual performance measured on a consolidated basis showed an 86% improvement at the PAT level due to the better results from overseas entities. The highly anticipated antidumping duty was not imposed by the U.S. This was a dampener for the R134a sales. The aggregate sales for the product were around 4250 MT; however, the silver lining was that we bagged the first order from Wal-Mart for supplying them R134a in cans, which as per our reports was well received by the consumers. We expect growing the relationship with Wal-Mart which could expand into other products being manufactured by SRF as well.

The Technical Textiles business unit at Rayong undertook a major overhaul in its polymerization section aggregating Rs.4.5 crore, and in the same business from the same unit, we wrote off debtors worth Rs.6 crore; a U.S. based importer raised certain issues and refused to pay, so we have taken a provision of Rs.6 crore on that.

The Belting unit in South Africa faced a strike as part of industry-wide action for about a month which led to disruption of production and in meeting of orders. The Thailand unit of Polyester Packaging Films operated at full capacity, gaining the leadership position in the market in the first full year of operations. The unit exports around 63% of its production.

The South Africa unit of Packaging Films was a slow starter and operated at about 82% capacity. There were challenges around the understanding of demand cycle and its phasing. The unit exports around 25% of its produce. Our strategy to sell greater quantities into the domestic market is being realised. The overseas entities which had reflected a loss of about Rs.55 crore at the PAT level last year showed a loss of Rs.5 crore only this year at PAT level, even though at the PBT level the entities were in the black.This is also in spite of the Rayong polymerization overhaul I mentioned earlier, the bad debt and the South Africa strike.

As expected the Company announced new CAPEX during the year aggregating over Rs.300 crore. The capitalisation this year was around Rs.574 crore, of which around Rs.450 crore was in Dahej alone and the balance in other businesses.

The story on Specialty Chemicals remains intact and our confidence on the segment continues to grow with the increasing prospects visible in the space. As we gain experience in this area, we see the horizon expand even further. From the experience in Specialty Chemicals, the Company has realised that there is greater value in being technologically ahead of the competition and hence it has taken the first steps of commencing R&D in its Engineering Plastics business as well through an announcement of CAPEX of around Rs.5 crore. So till now we had not been investing in Engineering Plastics in any significant manner for almost a decade. So, now we have invested Rs.5 crore in R&D for new product development.

I realise that you would be having specific questions on some aspects of our businesses, which I would be happy to address now. So, keeping my opening remarks very brief, I leave the session open for whoever is on the call to ask questions. Thank you.

Moderator:
Thank you very much, sir. We will now begin the question-and answer-session. We have the first question from the line of Manish Mathur from First Rand Bank. Please go ahead.

Manish Mathur:

A couple of questions, if you look at it on a consolidated basis, Packaging Films seems to account for a growing share of your entire revenue model and on the standalone basis that business unit is the Chemicals business, the share of Technical Textiles seems to be going down at least vis-à-vis FY14. Is this some kind of strategic shift as the Company seeing turning its focus away from the TTB to the Chemicals business or is this a one-time trend? Second, on the Chemicals business as such, we have seen that its performance has been improving consistently over the last 3-4 quarters backed by your confidence in the Specialty Chemicals business. Going forward where do you see the margins from this business peaking and what is the kind of pipeline you have in this business and over what timeframe do you see this business delivering the results that it has been delivering over the last 3-4 quarters?

Rajendra Prasad:

Thank you, Manish. I will cover the first one. Actually both your questions are stated positions of the Company given in previous calls; one is that we will not be incurring any growth CAPEX in Technical Textiles. We will limit our CAPEX in Technical Textiles to two categories — modernisation and upgradations — where the business of Technical Textiles is put at risk, at that point we will do CAPEX. So last time if you recall we had announced a CAPEX of around Rs.66 crore for our Gwalior Plant for upgradation of our twisters. So once this statement is made, it is natural that if I keep investing in other businesses, the weightage of other businesses will increase because of this, Technical Textiles business will remain generally constant, flat and stable. So what you are seeing actually is a manifestation of a policy that we had announced earlier and now we are seeing the results.

You have made a distinction between domestic and overseas. So naturally the Packaging Films businesses did not exist overseas. So 100% of overseas business till two years ago was Technical Textiles. So as something else is developing, the percentage of the existing business is going down because nothing more is being invested there.

As regards your second question, the Specialty Chemicals Business has been delivering good growth and generally improving margins. We do not usually make forward-looking statements, but in the past, I had said that the growth in the segment has been in the region of 50%, we expect that growth to continue maybe for a year or two. Because as the denominator increases, maintaining the same percentage of growth becomes difficult, so the percentage may go down., There are a whole lot of factors which contribute to increase in revenue. it is not only the new CAPEX, it is even the old CAPEX which is put to better utilisation as the plants stabilise. So, it is a cumulative impact of all that we have done in the past, plus what all we are doing in the future and at the present. So we believe this business will show similar patterns going forward, not identical, but I would say similar patterns of growth and profitability, Profitability might improve because the site or plants might be better utilized, which is one part.

The other part to this is the pipeline. I had earlier mentioned that we should view this business as a canvas, and on that canvas, there were certain molecules which were in the niche category and were getting us high margins; there were certain molecules which could have been introduced a few years back, which would get us normal margins and are not in the very high category; and there would be other set which had actually gone past the maturity stage. So if the canvas is populated adequately by the three kinds of molecules that should be the picture we should wish to see. The molecules may not be the same, but there should be enough molecules in each category. The pipeline that we have said and we have also discussed previously, is that we have about 70-odd molecules in the concept stage, that time I had actually mentioned 50, but this is the funnel, and in the funnel we keep picking up molecules to develop. So they are what we consider a category which has the potential of developing and growing and on which we could take R&D. So it is like a list, on which we had 72 such products which are in that category, on which we are doing literature studies, etc., on around 60-odd, and the lab scale work is happening on around 20+ molecules, of which the pilot we expect to take up nine and then into production and into maybe a dedicated plant. For those who have joined this call for the first time, the sequence is that there is a funnel, there is R&D, there is lab, there is pilot, there is flexible manufacturing plant, and if the demand is enough, and if the demand is consistent and for a longer period then we might put up a dedicated plant. Putting up a dedicated plant actually further reduces cost and increases margins. So this is with regards to Specialty Chemicals and how the business actually operates.

Manish Mathur:
If you look at the gearing and leverage of the Company on a standalone and consolidated basis, it has improved substantially over the last year. That improvement as we see seems to be driven more by EBITDA expansion rather than reduction in debt levels, because actually at standalone level the total debt has increased, and at a consolidated level, it has remained more or less flat. Going ahead, would the situation be similar say for FY16 in a sense debt levels are not likely to reduce much but EBITDA expansion is going to continue or will there be any substantial amount of deleveraging that will happen?

Rajendra Prasad:
The Net debt increased by Rs.160 crore, which we had anticipated. I can explain the reason for why it increased more than Rs.100-odd crore than we had projected, but to answer your question I think the leverage going forward will improve because we have seen the peak of debt. And as per our projections there will be a repayment of debt which is due, and like in the past year, there was a lot of substitution of debt leading to some incremental borrowing. In the coming year, there will be repayment of debt and leverage will improve further. Our policy is to maintain at least 1:1, but I do not think we will be able to maintain 1:1, it will be far lower than 1:1 debt-equity because there will be repayment of debt and there will be better EBITDA. So it will be a double impact and actually what happens, if you make more EBITDA, it has a double impact on debt-equity because with the cash, on the one hand EBITDA has become higher, and on the other hand with the same cash, you pay the debt, so your numerator and denominator both get impacted in reverse direction, so, your debt equity and debt-to-EBITDA show substantial change.

Moderator:
Thank you. The next question is from the line of Rahul Bhangadia from Lucky Investment Managers. Please go ahead.

Rahul Bhangadia:
My question was regarding all the three businesses, basically, in the sense that what is the return on capital employed expectations that you have from the various segments going ahead, as your CAPEX runs down and the debt goes down, you start making returns on the CAPEX, what is the ROCE expectations or ROI expectations on the various segments?

Rajendra Prasad:
Rahul, thanks for your question, it is a good question even though I am not a believer in ROCE, and the reason is in ROCE by definition there is some kind of capital which is in the denominator, the amount that you have invested, whether it is equity plus debt, whatever, and by virtue of time and inflation, your income keeps increasing. So investment today may look ridiculous to have been made, but 10 years later anyone who is assessing that investment will say a genius made that investment because the ROCE will look superb, because the profits have gone up by virtue of time or by virtue of inflation while the capital employed has remained the same. Having said that I believe that ours is a brick-and-mortar business and it is with a certain risk profile. In the past because we have been doing a lot of CAPEX, the ROCs have not looked good at all. Another thing with ROCE is they have to be measured at a stable performance level and assuming that there is no more CAPEX going on. We expect about 30% to 40% improvement in the ROCE as they exist today as we go along.

Rahul Bhangadia:
Let me put it the other way, ROCE, as you very eloquently explained, is a function of the denominator, what is the IRR of a project?

Rajendra Prasad:

If you were asking that I would have answered it appropriately; IRR is done at the time when the projects are approved, and they bring in the factor of time as well. So, we prefer IRR as a benchmark or a threshold at the time of making an investment. Now what we do every year is we calculate our WACC taking a certain desired debt-equity ratio which in our case we take as 1:1 on a theoretical basis, even though in most times we are better than 1:1, and we take risk-free debt, add the premium for equity, and this we do every year and calculate a WACC. On the WACC depending on the project, I take a 3 to 5% markup on the WACC for a project to be approved, unless it is a regulatory project or it is an environment health safety project or it is a strategic project just for the sustenance of the business. Other than that certain projects which are not based on IRR which could be R&D, which do not pass through this filter, but all business projects pass through a filter of WACC plus 3-5%.

Rahul Bhangadia:
What is the WACC that you have decided for the next year or what you have come to next year?
Rajendra Prasad:
The WACC for the next year is in the region of 12%.

Rahul Bhangadia:
So 15-17% project IRR is good enough for you to start thinking about it?

Rajendra Prasad:
That is right.

Moderator:
Thank you. The next question is from the line of Dixit Mittal from Subhkam Ventures. Please go ahead.

Dixit Mittal:
Just a word on R22, supposedly from July onwards OEMs cannot import the pre-filled compressor. So sir, what is your view on the pricing, what is the current situation and what is the expected situation in R22 post this ban?

Rajendra Prasad:
Dixit, firstly, let me congratulate you, you got the most current question. This is the happening thing. What has happened is due to our efforts and partially due to I think industry efforts, the mislabeled R22 that was getting imported, the import of that R22 has been highly curtailed, as a result all that material which used to get into the secondary market is no longer passing through and because of restrictions which are becoming tighter and tighter on R22, the prospects look bright.

Dixit Mittal:
This quarter did you see any margin expansion in R22 in Q4?

Rajendra Prasad:
This is a seasonal business, so what you would have seen is through the end of Q4, February onwards, not January and half-February, because it is a seasonal business. So, they stock up from February onwards, but we have seen margin improvements through the year in the secondary market because the smuggled gas is not available. So this is one segment which now we expect will do substantially better because of the restrictions playing the role.

Dixit Mittal:
We have seen on Chemicals segment quarter-on-quarter decline in reported EBIT margins; 20% as compared to 24-25% that we saw in the nine months. So is it due to composition of the order processing that you process lower margin orders or is it something else sir?

Rajendra Prasad:

No, I told you Chemicals segment has three parts, it has Fluorochemicals, Specialty Chemicals and Engineering Plastics. What you see in this is a composite picture of these three, two in the chemical business, the pure R&D expenses are also embedded which were little higher than last year. We have also debited like I mentioned around Rs.7 crore relating to Dymel expenses. About Rs.2.5 crore were P&L-related expenses of consulting, various fees, travel, due diligence, etc., which we did not capitalise because as per new accounting standards, such expenses should be expensed off, and we are a conservative accounting Company. Plus the assets that we capitalised on Dymel, even though they were intangible, there is a depreciation on that which comes to around another Rs.2.26 crore, so there is a pure expense added on account of Dymel which is Rs.7 crore in this quarter for the Chemicals business.

Dixit Mittal:

R&D and Dymel expenses came in Q4 in Chemicals business?

Rajendra Prasad:

R&D comes through the year, but we have a full-fledged R&D team, so the expenses come through the year, plus it is a seasonal business. Partly what you have said is also true that it could have had some campaigns which were not delivered before 31st March and needed to be delivered later. Thirdly, there has been a capitalization of about Rs.180 crore in this business(SCB), even though it was towards the end of March, it could have had some expenses of start-up, etc.

Dixit Mittal:

So what is the sustainable margins as a segment going forward sir because…?

Rajendra Prasad:

I think what you are seeing a pretty sustainable.

Dixit Mittal:

Is it for the full year basis?

Rajendra Prasad:

Exactly. Also to say that the more Specialty Chemicals goes in the segment because their margins are better than the rest, overall complexion should look better, but what is also happening is while Specialty Chemicals is doing very well, Fluorochemicals is also doing very well driven from Chloromethanes and R22, that segment is increasing its own margins. So both things are happening at the same time.

Dixit Mittal:

On R134a, what were the volumes that we did last year?

Rajendra Prasad:

I mentioned in my initial remarks also, we expected to do 8,000 tonnes, we did 4250 tonnes, which was because of the antidumping not happening, but that is a fact of life and we tried to recover from the situation and because we had made inroads into the U.S. market in our thinking that antidumping will come, we managed to get the first order from Wal-Mart of about 250 MT and this was in 340 grams can, which Wal-Mart has placed on its racks in our brand. So it is a Floron brand R134a can in Wal-Mart stores, and we learnt that about 2 lakhs cans have already been lifted. We had supplied about 7.5 lakh cans, of which I think one-third or little less than one-third have been already taken up by the consumers. Now we expect that Wal-Mart may place an order again, it is up to them, but since we are dealing with Wal-Mart, there could be other products that SRF makes that Wal-Mart could also take. So these are the possibilities.

Dixit Mittal:

Can you repeat the inventory loss that you incurred in Technical Textiles?

Rajendra Prasad:

In Technical Textiles I think in the region of Rs.9 crore in this quarter and in Packaging Films was Rs.6 crore.

Dixit Mittal:

What is our capital employed in Specialty Chemicals separately? Because total capital employed is Rs.2,300 crore.

Rajendra Prasad:

We do not do that, we just look at as Dahej together or Bhiwadi together and manage the P&L only separately, because the site is so integrated, it becomes difficult to allocate capital for common facilities and the fact is that if that common facility was not there, neither Fluorochemicals could function nor Specialty Chemicals. So it is very difficult to allocate capital for common facilities based on throughput, so it is not an algorithm that we have been able to work out till now.

Dixit Mittal:

What is the total CAPEX that we did in FY15?

Rajendra Prasad:

In FY15 we have capitalised Rs.574 crore.

Dixit Mittal:

Cash CAPEX that we did?

Rajendra Prasad:

Cash CAPEX would be around Rs.400-odd crore. Because in this Rs.574 crore, part was over hang of the CAPEX already incurred last year and capitalized this year and Rs.180 crore was the project which we started in this year and ended in this year, which is what we capitalised around 27th March, which is for the product called P17, so that got capitalised in March-end. So that is Rs.180 crore of cash approved and commissioned this year, part of previous year CAPEX came in. So overall it would be about Rs.400 crore of cash.

Moderator:

Thank you. The next question is from the line of Abhijit Akella from IIFL. Please go ahead.

Abhijit Akella:

Just on the Specialty Chemicals business, you mention that you normally look to set up a dedicated plant only once you get a firm commitment from the customer for 3-5 years or so. So, is that typically the order duration that you have in that Specialty Chemicals business that you have a firm order in hand for say 3-4-5 years?

Rajendra Prasad:

It works in steps, because we are in a way co-developing the molecule with customer, he also starts off buying small quantities and there is no commitment at the initial stages, even if I go into R&D, even if I do a pilot, there may not be a commitment or committed order in our hands. Once we supply certain quantities and they find them proper, by the time we get a hang and a better understanding of the pricing, we are able to let us say give them kilo quantities and be able to indicate a price, then they may take certain amount, which they may want for a particular campaign or a particular batch. So at this point it would also be a one-off order, then it will probably move to the next stage and they say we want smaller quantities through the year which we can process through a campaign in a flexible manufacturing plant still not deserving or warranting a dedicated plant. So a dedicated plant is when the customer commits to us a longer period order may be three years, normally does not extend beyond three to four years, so it will be three years and a certain known committed quantity every year when we set up a dedicated plant.

And other thing in this context I should also tell you that even when we set up a dedicated plant, the plant is not at great risk of the order being cancelled or of the customer discontinuing supplies or the molecule going out of fashion, because the same plant with some modifications can be used for producing something else downstream or producing some other associated product which might find its own market. So we set up the dedicated plant with this comfort in mind that even though he has committed an order to us and to take up certain quantities because of customer relationships, if they decline, it is not a big deal.

Abhijit Akella:

So, is it possible to share the total order book you have in hand for these kinds of 3-4 year projects right now?

Rajendra Prasad:

No, but suffice it to say I think that we have at this point four dedicated plants. So in the funnel that I explained our intention is that out of the 50, 60, or 70 numbers of molecules we have in the funnel, at least 5 should go into flexible manufacturing and at least 1 every year should pass through to the dedicated plant. If that happens, it is a pretty good deal. And also you should appreciate that this whole process is quite accumulative. So if I have four dedicated plants and I put a fifth one, the four are also producing specific products for specific people, it is not that they have gone off-stream.

Abhijit Akella:

So this year the Specialty Chemicals revenues would have been Rs.600 odd crore?

Rajendra Prasad:

Yeah, that is what we had anticipated and by and large it has met our expectation. We had said that in the past five years it has grown at the rate of 50%. We expected the same trend to be maintained plus, minus a few percentage points the general trend has been maintained.

Abhijit Akella:

Out of this Rs.600 crore just roughly, would the dedicated plants actually be the major contributor or is there a wider dispersion across?

Rajendra Prasad:

There is wider dispersion. At the moment you make some limited quantity for someone you get a better realisation.

Abhijit Akella:

But, would it be fair to say that by and large the flexible plus the dedicated plants would be the vast majority of these revenues?

Rajendra Prasad:

That is right.

Abhijit Akella:

You have in the past mentioned that your Specialty Chemicals business is different from Custom Synthesis the way the other companies describe it. The key difference would you say is the fact that you own the process and therefore you file for the process patent and everything whereas in Custom Synthesis it is normally the innovator who helps the manufacturer or what is that? The key difference is are there any other attributes or differ as well?

Rajendra Prasad:

What you have said is 100% right, the key differences that we own the process, and last time if I remember correctly I had said that we have 39 patents, right now I think the patents application pending are around 54, and from the total number of application which we have filed earlier, I think 8 or 6 patents have come through because getting a patent takes a long time. So, the process is up and what it also leads to is that we can sell the product to multiple buyers.

Moderator:

Thank you. The next question is from the line of Pritesh Chheda from Emkay Global. Please go ahead.

Pritesh Chheda:

Just want to know R22, what is the market size in India and how much of it was actually import-fed?

Rajendra Prasad:

No, import-fed technically we cannot have data because it was illegal, it is not permitted to be imported, so it is very-very vague numbers, but our growth in the service segment has been 35%, that is the secondary market.

Pritesh Chheda:

The volumes that we would have sold?

Rajendra Prasad:

Again, one cannot increase capacities. So the capacities for the purposes of selling a gas, you cannot increase capacities. So, our capacity is around 12500 tonnes, we produce to the hilt, and we use this as a feedstock also. In fact our position today is that for feedstock at times we buy from outside, because our own R22, we want to sell into the market. It is today we are actually in a sense short of R22 and our secondary market share has gone up by 44% and our primary market has gone up by 22% market share because no pre-charge ACs are coming in like Dixit was also mentioning, so a pre charge ACs do not come. Earlier what was happening while imports of gas was not allowed, some of the white goods manufacturers selling ACs in India were importing ACs which already had the compressor charged with R22 and they were rebranding them into local manufacturer names and selling them in the domestic markets. Now pre-charged ACs cannot be imported. So naturally the local gas has to replace that.

The other thing which I should mention since we are in refrigerant gases, last year we have started marketing blends in our own name, so namely they are three blends which are R404a, R407c and R410a. These blends basically have three gases – they are R134a, they have R32 and they are R25 in different proportions; some of them may have only two gases and one of the gas will have all the three gases. So we using our own 134a, we are importing other two gases and making blends and selling these blends because these blends are also being used in ACs.

In the same context, I should also tell you that R32, which is another gas used for Air Conditioners, has been approved by the environment body in the U.S. to be used in Air Conditioners. Earlier, there was some reluctance because it is a little inflammable compared to the other gases. So R32 like it could be a partial substitute for R22, so not only is this R32 used in the blends that I mentioned, it is also used standalone in Air Conditioners. Many calls ago I think on the first call people asked me that what will you do with the Bhiwadi plant of R134a once the Dahej plant is commissioned, that time we had three options — we could shift the plant to Dahej, we could shut it down, we could continue to run or modify it. We are looking and exploring at the possibility of modifying it with some CAPEX into producing R32. If that happens with the minor CAPEX then in the blend gases, I will be making two components out of three — R134a and R32 — and there are certain Air Conditioning companies which have already announced. I think Daiken is one of them, that they will use R32. So we would then be in the market for R22, R134a, R32 and then the blend. But this is just to give you a full wrap-up on the Air Conditioning business.

Moderator:

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

Avinash Agarwal:
On the subject, you mentioned that we are kind of buying some feedstock even from outside right now for R22. How much would we be using internally and out of the 12500 tonnes, what would be our internal say requirement out of that?

Rajendra Prasad:
At this point I do not have that internal consumption number, but it is increasing because as we develop products which are based on R22, in our Specialty Chemicals business, we have three family trees based on three raw materials; HF is one of them as you know, KF is Potassium Fluoride and R22. So as the number of products made on R22 tree increases our internal consumption increases. But why it helps is in the lean month, when there is no demand of R22 outside, I can continue to use it as feedstock. So my plant does not have to reduce or stop producing. So we can use the internally manufactured gas during lean months.

Avinash Agarwal:
Sir, this phasing out of R22 from India as a gas, till when is this sir?

Rajendra Prasad:
I mentioned again earlier also that while the gas may get phased out and I think 2020 will be the year major reduction which will come, we do not expect we will have to shut down the plant because by that time I would have shifted enough demand into feedstock. My demand in feedstock hopefully should reach 11,000 to 13,000 tonnes so that I do not need to shut down the plant. Just now what we have transferred about 3,000 tonnes for internal consumption, I just got you the figure.

Avinash Agarwal:
Sir, in terms of the flexible manufacturing plants, how many do we have that today?

Rajendra Prasad:
Today, actually we have three; two we call flexible manufacturing plants, and one we call multipurpose plant, but in nature they are three flexible, they are three plants which are of a flexible nature.

Avinash Agarwal:
On Wal-Mart, you mentioned that there are other products that we could look to sell there. Any indication as to which product you are talking about?

Rajendra Prasad:
Let me precede my statement with the caveat. Indication could be from my mind and not what Wal-Mart has asked. If I was to go in sell products to Wal-Mart, I could be selling coated fabrics, I could be selling laminated fabrics, so those are the things which we think could be sold there and in case Wal-Mart wants to identify our Packaging Films for some of the things that they manufacture, because Wal-Mart also gets certain things manufactured in its own brand. So if they want to use our film for packaging some of their goods, maybe that could be a prospect.

Avinash Agarwal:
What is our CAPEX estimate for next year?

Rajendra Prasad:
I think it should be at least Rs.200 crore plus overhang; when I say Rs.200 crore it is always of new approved CAPEX, because there always will be an overhang from the previous year.

Avinash Agarwal:
What I meant was cash CAPEX?

Rajendra Prasad:
If you equate the overhang effect from one year to the other end you think equal amount of CAPEX will be outstanding. Cash CAPEX should be the same as approved CAPEX on an ongoing basis. Whatever is left over, cash will be used in the next year and some part of the next year will be left over again. So, it should be in the region of Rs.200-250 crore, but sometimes we cannot predict that accurately especially let us say in the case of Dymel. We did not see Dymel coming all along when I was telling you that the CAPEX will be Rs.250 to Rs.300 crore last year and suddenly add capital investment to fund the acquisition of Rs.126 crore, and actually if you look at it, if this was the unplanned CAPEX, this has partially accounted for the increase in debt beyond what we said.

Moderator:
Thank you. The next question is from the line of Aditya Ahluwalia from Invesco. Please go ahead.

Aditya Ahluwalia:
Just wanted to confirm the revenue number for Specialty Chemicals?

Rajendra Prasad:
It is a difficult question, we do not segregate it, but suffice it to say that it has generally maintained its growth path; less than 50%.

Aditya Ahluwalia:
On the R22, do we expect an increase in realizations now, does the domestic market looks better?

Rajendra Prasad:
I would say so.

Aditya Ahluwalia:
On a consolidated basis, can we get some direction on the margins going ahead, just an indicator?

Rajendra Prasad:
Yeah, we do not give these kind of directions because we do not believe in it, in the sense that we do our best and I think better margins follow, but I would believe margins should improve because if you look at each business. Packaging Films Domestic is doing very well, and it is a market knowledge that the prices are improving, hardening a bit, margins are improving in the Packaging Films. Overseas, as well as the excess supply gets consumed over a period of time, the plant utilisations will improve and hence margins should also improve. As far as Technical Textiles is concerned, there is a lot of expectation around mining sector, and if mining sector in India opens up, the belting and nylon tyres demand should go up especially because of the road vehicles and mining and construction equipment, tyres are generally nylon. So, again we expect, as the demand hardens even price realizations and margins should improve. Temporarily, you will see in this segment margins improving because of the reversal of the crude price. So the hit that we have taken in the last two quarters will partially get compensated by the increase that we have witnessed over the last 15 to 20 days in crude. So, Packaging Films and Technical Textiles should be beneficiaries of that reversal.

As regards two Chemicals business, we talked about R22, R134a as our plant hopefully makes more than 4250 tonnes that we made this year, the efficiencies improved drastically which we have seen in the past, and efficiencies not only of the main plant but also of the two feeder plants of Hydrofluoric Acid and TCE, PCE, so as the mother plants start consuming more, these two plants also will be able to churn out better efficiencies overall leading to better margins.

One of the reasons we have not gone aggressively into the US is because we know that the anti-dumping action is being revived with greater focus. So if we were to actually feel that we can make R134a competing with China which we could, we still do not want to export into the US at those prices because the antidumping action could cover us as well, so we do not want to jeopardize and actually risk SRF's pricing to be covered under the anti-dumping duty investigation which will take place. So from that point of view, I hope R134a will also improve. Specialty Chemicals has its own margin structure. So overall as a Company, we should see improving margins. That is my thinking and just going by knowledge of what exist in the public space.

Aditya Ahluwalia:
I wanted to know the production and the utilisation in Thailand and South Africa?

Rajendra Prasad:
Thailand was a success story, I mentioned that we are #1 position in market share, its 100% utilisation in Thailand, the capacity is around 28000 tonnes p.a., we produce 2000 tonnes per month. In South Africa, the utilization is about 80%, I think we done about 21000 tonnes on a rough capacity of 25,000 tonnes. Thailand actually if you take breakdowns, etc., the total would come to 93%, if you take normal stoppages for change of films, etc. Because when it runs it is at 100%, but there are normal stoppages which take place when you make that type of film.

Aditya Ahluwalia:
The number for South Africa would be around 70%?

Rajendra Prasad:
Right, and that is in the last year, actually in South Africa, the real challenge was in the selling, in the sense that because it has a very marked season and off season, so December to January it is kind of off season, but before that you should have enough inventory to be able to sell preceding December. If you do not have inventory you would not be able to take advantage of the pricing and the demand at that point of time plus in the lean season you should be able to export. So these are very specific behaviours of the South African market which we did not realize at that point of time. Now we are one season wiser, so I think this time it will be much better around.

Aditya Ahluwalia:
So sir, going ahead, we are going to report consolidated quarterly, is that correct?

Rajendra Prasad:
There is no regulation to do it and because reporting means that it has to be with at least the limited review because domestic results are limited review, the consolidated also have to be limited review, we are looking at the timelines whether we can with the external auditors in those countries, manage consolidated results, we will do it. But our intention is to do it as soon as possible start reporting consolidated results on a quarterly basis. That is our intention. Even though we are sure that our unaudited or without limited review, the results are fair, we still cannot consolidate unlike items. So both need to be limited review for them to be consolidated. But, our direction is that even if it is not required by regulation.

Moderator:
Thank you. The next question is from the line of Siddarth Mohta from Principal PNB Asset Management India. Please go ahead.

Siddarth Mohta:
In your initial remarks, you have mentioned that the fall in the EBIT for Packaging Films it was mainly on account of fall in crude price, is that the correct assumption sir?

Rajendra Prasad:
By and large, yes.

Siddarth Mohta:
Sir, you have also mentioned that in Domestic Films market, the prices are improving. If you can also help us with the quantum especially for our 8 micron?

Rajendra Prasad:
I did some asking around before I came on to this call. Do not go by price because if the price of chips have also fallen, the price of film will also fall. So, what is critical is the margin. Now, let me tell you that the margin between April '14 and in March '15 there has been an improvement in margin of Rs.10-15 per kg depending on the film and Rs.10-15 improvement on the margin is per kilo a substantial sum.

Siddarth Mohta:
Secondly, you mentioned that in South Africa, there was some inventory management issue and now you experience the same. So one can assume that in FY16, both Thailand and South Africa can also contribute to the PAT level?

Rajendra Prasad:
Yes, in fact, South Africa is expected to contribute more than Thailand, because South Africa is BOPP, and South Africa was set up with the intention that it will have close to monopoly in South Africa, it will have better realizations in the market of South Africa. Even this year, as per our budget, South Africa was supposed to perform better than Thailand. But Thailand on the back of its high production, has produced better than South Africa.

Siddarth Mohta:
In FY16, improvement from South Africa we can expect?

Rajendra Prasad:
Absolutely.

Siddarth Mohta:
Regarding the one-off, you have mentioned across all your three divisions, total it was Rs.9 crore, of that Rs.6 crore in Technical Textiles and in Specialty Chemicals due to acquisition it was Rs.5 crore?

Rajendra Prasad:
No, in Technical Textiles alone, it was Rs.10 crore due to crude and Rs.6 crore in Packaging Films and Rs.7 crore due to Dymel in Chemicals business.

Siddarth Mohta:
So everything has been routed through our P&L account?

Rajendra Prasad:
Yes, because there could be some companies would take the acquisition expenses into capitalisation, but that is not as per the standard today.

Siddarth Mohta:

Sir, going forward, what would be your tax rate in FY16 or '17?

Rajendra Prasad:

It is too volatile, even while we are doing the calculations for this year, till the 11th hour we could not make out because there is a switch between MAT and tax credit and the change in rates. Something else I should mention is which we also did not realise. All the deferred tax credit which is lying if there is a change in tax rate, all the deferred credit gets valued at the higher rate. So the whole cumulative impact of past deferred tax hits you in this quarter. So let us say I had Rs.10 crore at 30% and it becomes 33% tax that Rs.10 crore will become Rs.11 crore, 10% increase will take place in deferred tax itself. We will have to take that as a debit as a hit in our business, which we have taken in this quarter.

Siddarth Mohta:

That has been accounted for?

Rajendra Prasad:

Yeah, what I am saying is these are very hidden things which happen and you realize when it hits you.

Moderator:

Thank you. The next question is from the line of Rohan Gupta from Emkay Global. Please go ahead.

Rohan Gupta:

Sir, on the three chemistry which we are following in our Specialty Chemicals Business; HS, KF and R22. Since our focus will be more on R22 based chemistry, the internal consumption right now roughly 3,000 tonnes we are planning to take it to almost 13,000-14,000 tonnes over next four years. So, is there any margin difference between these three chemistries?

Rajendra Prasad:

Firstly, right now, the focus was not on R22, we did not start in Specialty Chemicals with R22 as a feedstock. HS and then KF and because we wanted to have some products which use R22 we started off on the chemistry using R22 as the raw material. So, actually margins are not as much chemistry-based as the product that you are selling. And many of these chemistries they are not independent. Could be using HF, where the major raw material is R22. So it is very difficult to distinguish margin based on source raw material.

Rohan Gupta:

So it is not like that because for the higher captive use of R22, our margins will not erode or our Specialty Chemicals margins which are close to 24-25% in that range, they are likely to remain there?

Rajendra Prasad:

Yeah, I would say they will remain there or if we are going to sacrifice margins, I would rather not put up the plant with R22, because R22 today also that plant is a very old and depreciated plant. So it is a simple arithmetic. For the sake of using R22, why should I deplete my margin?

Rohan Gupta:

One question which was asked initial that about the new CAPEX and we take the WACC as a 12% and then you are talking about 16-17% are the return ratios you are comfortable with?

Rajendra Prasad:

Yes.

Rohan Gupta:

So, that is the minimum criteria?

Rajendra Prasad:

Minimum threshold you have to pass.

Rohan Gupta:

Minimum threshold is 16-17% but definitely I assume that we will be looking for higher projects of 20% plus?

Rajendra Prasad:

Because if we are close to 16-17% or below, the project may not be passed and it is always a question of competing demand for the same resources. So at that point of time, I have a project which is doing 22%, I will not even look at 17%.

Rohan Gupta:

So ongoing CAPEX which we have roughly Rs.200 crore for this year also, so there the return ratios which we have kept in mind is can we expect 20% plus or they are just at the threshold level?

Rajendra Prasad:

Let me tell you that in the recent past we have been more than 20%.

Moderator:

Thank you. The next question is from the line of Kamal Gada from UTI Mutual Fund. Please go ahead.

Kamal Gada:

We did around 4,200 MT of HFC 134a last year FY15. Wanted to understand this is Dymel acquisition, what kind of incremental volumes can we look at as far as HFC 134a is concerned?

Rajendra Prasad:

Right now, Dymel is being procured from DuPont, and this arrangement is expected to last about 2 years. It is only after that our R134A get used. By that time the demand which is today at 1,200 tonnes, we expect by the time the demand should be upward of 1,500 tonnes.

Kamal Gada:

Secondly, our Technical Textiles business in South Africa also did well because I was just seeing the consolidated performance?

Rajendra Prasad:

They did not do well because of a one month strike, which was an industrywide strike, so we got included in that strike and because of that some of the customers canceled orders because they needed material immediately. So there was a production loss of around Rs.4 crore in South Africa.

Kamal Gada:

I was just seeing the consolidated EBIT in Technical Textiles is higher by around Rs.20 odd crores over standalone EBIT. So I was just wondering which of our unit has done well?

Rajendra Prasad:

What has happened is even though in Rayong we have taken a hit of Rs.4.5 crore, after we had done the overall polymerization plant, the efficiencies have greatly improved. So the benefit has not come fully, but it is expected and things like break rates, etc., have far reduced, so they have improved. So partly I would say Rayong only would have done better at the revenue level.

Kamal Gada:

I was talking of the profitability, consol EBIT is Rs.195 odd crore and the standalone EBIT is around Rs.175 odd crore, so I have just subtracted the two, Rs.5 crore last year is 20 crore?

Rajendra Prasad:

Overseas Technical Textiles is not that big in any case, it is generally a steady business.

Moderator:

Thank you. The last question is from the line of Dheeresh Pathak from Goldman Sachs. Please go ahead.

Dheeresh Pathak:

When you said Rs.9 crore and Rs.6 crore of inventory loss and then Rs.5 crore, so roughly in this fourth quarter we have Rs.9 crore plus Rs.6 crore plus Rs.5 crore, almost like Rs.20 crore of one-off?

Rajendra Prasad:

That is right.(In domestic results)

Dheeresh Pathak:

In the Rs.5 crores you break it out between…?

Rajendra Prasad:

Once you talk of Rayong, and then you are talking of consolidated numbers, which naturally are on an annual basis.

Dheeresh Pathak:

But all this came in the fourth quarter, right?

Rajendra Prasad:

No, because you did not see the consolidated numbers in the previous quarter's no. So this is the annual impact. What you are saying is true for annual. Dymel was Rs.7 crore which was in this quarter, Rayong was Rs.4.5 crore which was not in this quarter, Rs. 6 crore was debtors' write-off which was not in this quarter. So if you were to see the consolidated results on an annual basis, that would have all this debited in it already, but not on the quarter.

(Additional clarification: Domestic: During the quarter the losses on account of crude based raw materials, finished goods and WIP are estimated at Rs.9crs and Rs.6 crs. in technical textile and packaging films businesses in addition to one time expenses related to Dymel acquisition. In addition, during the year in the international business, the Rayong plant incurred exceptional expenses of Rs.4.5 crs. on the overhaul of the polymerization plant and a provision of Rs.6 crs. for doubtful receivable. In South Africa the strike during the year cost us about Rs.4 crs)

Dheeresh Pathak:

On the DuPont related acquisition, you said Rs.5 crores of one-off, in that Rs.2.5 crore you said was consulting, and Rs.2.5 crore was intangible amortisation, which is ongoing right?

Rajendra Prasad:

No, intangible depreciation will not be ongoing forever because there were certain intangibles which had a life of only 18-months or 2.5-years depending on what that intangible was. So we have taken a conservative view and we are going to amortise it over whatever that period is. Suppose, there was a value to a customer contract, that customer contract is only for 18-months or for 2.5-years. I will amortise that value over that 2.5 years and get over with it. There would be technology which will be for a longer period.

Dheeresh Pathak:

This 2.5 years then on intangible would not recur from next quarter?

Rajendra Prasad:

Part of it would not recur. So let us say out of this Rs.2 crores might continue to recur or Rs.1.75 crores may continue to recur, the balance may not recur.

Dheeresh Pathak:

In the Chemicals business of Rs.1,260-odd crore, third-party sales of R22 contributes around how much, just a ballpark number?

Rajendra Prasad:

Ballpark you can take this as 8300 tonnes The amount of R22 that we have sold is Rs.160 crore, this is third-party realization for the full year.

Dheeresh Pathak:

So then this would be the largest single product in our Chemicals business, after this would be R134?

Rajendra Prasad:

Rs.190 crore was total, Rs.160 was third-party.

Dheeresh Pathak:

Something from a single molecule point of view, this would be the largest category within the Chemicals business, right?

Rajendra Prasad:

R134a is equally big.

Moderator:

Thank you. I now hand the floor back to Mr. Ritesh Gupta for any closing comments. Thank you. And over to you, sir.

Ritesh Gupta:

I just had one more question, sir, on your balance sheet, on working capital side I see a sharp reduction in payables by about 25-26 days consolidated. Now that is on account of what factor, sir?

Rajendra Prasad:

It could just be a snap-shot picture. Balance sheet figures are as on a particular date.

Ritesh Gupta:

But, we see a very sharp reduction like 27-days is fairly big. So is it on account of one thing in particular?

Rajendra Prasad:

I do not have the answer to that.

Ritesh Gupta:

I will take it offline. Thank you sir, thanks a lot for answering all the queries. I will hand over the call to Mr. Mukund Trivedy for closing remarks.

Mukund Trivedy:

Thank you, Ritesh for organising this call, and all those for being on the call.

Moderator:

Thank you. Ladies and Gentlemen, on behalf of Ambit Capital, that concludes this conference. Thank you for joining us. You may now disconnect your lines.

Note:

1. *This document has been edited to improve readability.*
2. *Additional comments / clarification have been provided against some questions to remove doubts*
3. *This is a transcription and may contain transcription errors. The Company takes no responsibility of such errors, although an effort has been made to ensure high level of accuracy.*