



CHAMBAL FERTILISERS AND CHEMICALS LIMITED

Quarter 3 FY 2017-18 Results

Investor/Analyst Conference Call Transcript February 14, 2018

Neha Patil: Thank you. Good afternoon and thank you for joining us on the Chambal Fertilisers and Chemicals Ltd. Quarter - 3 FY18 Earnings Conference Call. Today, we have with us the senior management represented by Mr. Anil Kapoor – Managing Director, Mr. Abhay Baijal – Chief Financial Officer, Mr. V K Gupta – Vice President (Marketing), Mr. Anuj Jain – Assistant Vice President (Finance) and Mr. Rajveer Singh, Assistant Vice President - Legal & Company Secretary.

Before we begin, I would like to add that some of the statements to be made in today's discussion may be forward-looking in nature. We will begin the call with opening remarks from the management after which we will have the forum open for interactive Q&A session. I would now request Mr. Kapoor to make his opening remarks. Over to you sir.

Anil Kapoor: Thank you Neha. Good morning ladies and gentlemen. At the outset, let me apologize for the short delay because of communication problems which we have faced. I would like to welcome you all to our Earnings Call post-declaration of Results for the Quarter and Nine-Months Ended December 31, 2017.

It has been a good quarter for Chambal Fertilisers. During the third quarter of FY 17-18, our revenues including other income remained at Rs. 2313 crores against Rs. 2432 crores for the corresponding quarter of last year. However, on the profitability front, we have done reasonably well. The profit before tax from continuing operation has increased by approximately 30% to Rs. 229 crores as against Rs. 177 crores of the corresponding quarter of last financial year. Profit after tax from continuing operation has also increased by 14% to Rs. 149 crores against Rs. 131 crores during the corresponding quarter

of 2016-17. The profitability was backed by increase in sales volume of urea and better margins on marketed products. We sold 16.51 lakh tons of urea during nine-months ended December 31, 2017.

It is important to note that our new urea project is progressing well and we expect to achieve the commercial production as per schedule by January 2019. We have spent approximately Rs. 3614 crores on this project till January 31, 2018. I will now request all participants to ask questions which you may have with regards to the result or with respect to the project. Thank you.

Moderator: Thank you very much. We will now begin with the question and answer session. We have the first question from the line of Apurva Bahadur from ICICI Securities. Please go ahead.

Apurva Bahadur: Sir, two questions. Firstly, I would like to know your views on the reduction in urea subsidy in the next budget of year 2018-19. So, what do you think what has actually driven the government given that the gas prices are actually going up?

Anil Kapoor: As far as we look at it, the government should be able to give our Urea subsidy claim by and large for the entire year. That much money they have kept. As far as Urea subsidy is concerned I do not foresee any major problems.

Apurva Bahadur: Okay, so with the given allocation they will be able to clear the current subsidy which will be accrued during the year, but for any backlog there will have to be an additional allocation.

Anil Kapoor: As far as urea is concerned, I do not think there should be any major backlog also.

Apurva Bahadur: Okay, so the entire backlog will be cleared.

Anil Kapoor: That is right. Moreover, with DBT now getting implemented, there will be certain staggered payments which will take place and bunching of payments will also take place. For example, whatever we now sell in the month of March, April and May, the bulk of it will be sold only to the dealers and may

not be sold through the POS machine to the farmers. This subsidy we will receive in the month of June and July. Likewise, similar problem will take place in the last quarter of next financial year. We do not foresee any shortfall in urea subsidy.

Apurva Bahadur: Great. Second question is linked to this only. You spoke on the DBT sales. I just wanted to understand the accounting part of it. For example, whatever we will be selling in these non-peak months, let us say March, April, May, the sales will be recorded only for the non-subsidized portion and the subsidy portion will be a part of inventory on this. It will be completely recorded during the actual sales?

Anil Kapoor: At the outset, I would like to mention that in Chambal by and large we account for only the sales which is likely to be sold to the farmer. We do not sell much of fertilizer as a book sale to dealers. But, as far as accounting practices is concerned, we will still account by the old methodology that we will account for the total amount as a first point of sale to the dealer.

Apurva Bahadur: Okay but the subsidy clearance will happen only during these actual sale months.

Anil Kapoor: Subsidy clearance is a different issue. That will take place in the month when the sale takes place to the farmer. But accounting will take place when we have sold to the dealer.

Apurva Bahadur: So, essentially, every quarter-on-quarter, there will be no seasonality as such on the revenue side?

Anil Kapoor: You are absolutely right.

Apurva Bahadur: Thanks a lot sir.

Moderator: The next question is from the line of Siddharth Mohta from Principal India.

Siddharth Mohta: Sir, with respect to urea budget, my understanding was that government has reduced the budget for urea manufactured in India and they have increased the budget on the imported urea. Is that the correct understanding sir?

Anil Kapoor: We are not very clear on this bifurcation right now. Let me do one thing, before we close this call, we will try and get you this feedback.

Siddharth Mohta: And sir, with respect to your new capacity of urea that is coming, our understanding is that government is going to reimburse subsidy till 100% but beyond 100% the policy was not clear. So any update on that?

Anil Kapoor: This is for the new project?

Siddharth Mohta: Yes sir.

Anil Kapoor: We also do not have clarity on this subject as of now. Because our project size is 1.34 million tons, what will happen beyond 1.34 million tons we do not know? As far as projection is concerned, we only project up to 1.34 million.

Siddharth Mohta: So which is 100% actually.

Anil Kapoor: Yes, 100%.

Siddharth Mohta: And sir, for this existing urea policy with respect to cut off which generally happens in quarter 4, so we used to account for each and every quarter i.e. quarter 1, quarter 2, quarter 3, or how does it happen sir?

Abhay Baijal: The policy is to recognize the contribution up to 100% till it is achieved and then we make an adjustment in the final quarter based on the final beyond 100% numbers so that final adjustment takes place in the last quarter.

Siddharth Mohta: And sir, the IPP which is being benchmarked for cut off, does this looks good actually?

Anil Kapoor: We will be okay. We should get our entire amount.

Siddharth Mohta: And sir, if you can also throw some light on the DAP prices. In the last Quarter-2 con-call you said that we are getting the DAP at USD 350 to 360 per ton but now the prices has increased to USD 410 per ton and even some of the manufacturing players have increased the price by Rs. 2000 to 3000 per ton. So what is the current situation? Do you think that they will be able to pass on the prices to farmer?

Anil Kapoor: Let me be honest with you, there is total uncertainty in the market today. As we speak today, we do not know what the price of DAP is likely to be and what the acid price is likely to be next quarter. This quarter you know what the price of acid is. Some of the importers have bought small cargos here and there but no major purchase has taken place. Bulk of the purchase will take place in the first quarter next year. So, at this moment, we do not know where the prices are held. It could go upwards from USD 410 per ton also. So then what will happen to the MRP? What is the subsidy which the Government of India is going to give? There is total uncertainty on this subject as we speak right now. This is also an election year. We do not know what the government will be thinking. So there is an uncertainty and that is the reason why I do not want to commit anything else right now.

Siddharth Mohta: So, in FY17, we have done a revenue of Rs. 7500 crore, so out of which how much will be non-urea portion which is DAP and seed and agro division?

Abhay Baijal: The non-urea operation up to 31st December 2017 is roughly Rs. 3300 crores.

Siddharth Mohta: And sir, in the past we have been making very good margin in this non-urea segment. So what is the current status? Are we able to make the same margin in this quarter also?

Anil Kapoor: Please come again?

Siddharth Mohta: Sir, in terms of margin as far as non-urea is concerned, in the past we used to make Rs. 1000 to 1500 per ton. So have we been able to make same margin in this quarter also?

Anil Kapoor: In the third quarter or fourth quarter?

Siddharth Mohta: In third quarter.

Anil Kapoor: Third quarter, we have been able to maintain margins consistently as what we have maintained in the first three quarters. Approximately the same.

Siddharth Mohta: Okay, and the number would be around Rs. 1000-1500?

Anil Kapoor: These are market related operations. You will appreciate they are very confidential. You can calculate yourself. You people are all very intelligent.

Siddharth Mohta: Yes sir, just wanted to reconfirm.

Anil Kapoor: I have some numbers regarding the subsidy which is being provided. As far as budget of FY 2017-18, the provision was Rs. 40,000 crores for urea including freight which was revised to approximately Rs. 37,000 crores. Now in budget of FY 2018-19, we are going to get Rs. 35,000 crores. So, there is a marginal reduction by about Rs. 2000 crores which we do not foresee any major hiccups for urea industry.

Siddharth Mohta: Sir but within this, there was a bifurcation of manufacturing and imported.

Anil Kapoor: Imported is separate. The number which I have given you is only for indigenous.

Siddharth Mohta: Okay, then it is not a major reduction. Sir but any specific reason why they have reduced the budget?

Anil Kapoor: They must have anticipated when they did the calculation that it is not needed. See, what the government is thinking today is that they do definitely give priority to urea and then they give priority to non-urea operations. And moreover, as Mr. Jain has rightly prompted me, the carry-forward subsidy of urea this year will be substantially lower than what was carry-forward last year.

Siddharth Mohta: Okay, hence this budget of Rs. 35000 crore versus Rs. 37000 crore. Last question from my side is what would be the current gas prices that we are getting?

Anil Kapoor: USD 10.73 on NCV basis.

Siddharth Mohta: This is the current price which is ruling as of now?

Anil Kapoor: This is the provisional pooled price in month of January in dollars per million BTU.

Moderator: The next question is from the line of Nikhil Ranka from Reliance Treasury. Please go ahead.

Ajay: Hi Sir, this is Ajay here. Just if you can explain how do you see the overall commissioning of the new capacity, meaning from which quarter do you expect the overall ramp up and by which quarter you see the whole capacity getting commissioned meaningfully and contributing to our numbers. Secondly, there are too many uncertainties as you mentioned just now regarding quite a few things. So, when our capacity is fully operational, what issues do you see in terms of when we place material into the market, do you see any major issues to that or what are your thoughts on that?

Anil Kapoor: We expect the plant to be commissioned by January 2019. So, in the fourth quarter of next year i.e. fourth quarter of 2018-19, we are not anticipating a very large production coming through. The plant should basically operate between 80% and 90% capacity utilization for two and half months in Q4. As far as financial year 2019-20 is concerned, we should get 95% to 100% capacity utilization. Chambal is known to commission plants very efficiently at least. As far as Gadepan-I and II track record is concerned, we commissioned on time and ramped up as fast as possible. I can only go by our track record. What will happen, time will tell. As far as sales is concerned, India does import at least 4 million tons of Urea, if you take OMIFCO out. So when our production comes on stream (a) the imports will come down, so we do not anticipate major problem in selling; and (b) Chambal's urea brand is

very strong in our territory. Literally, in few states, it is a first buy for the farmer and then it moves to other urea. So we do not foresee any problems in selling.

Ajay: And with respect to policies also, you do not see any major changes happening which can impact your overall volumes?

Anil Kapoor: No, definitely no.

Ajay: So by end of FY20 what sort of debt levels one should expect?

Anil Kapoor: Very forward-looking. I will answer this question may be in September next year.

Ajay: But ballpark sir, I am just saying considering the trajectory.

Anil Kapoor: You know the policy. The entire policy is on the internet. You can do your own calculation. I have told you 95-100% capacity utilization. I have also told you we do not foresee any problems in selling. So, it will not take more than half an hour for you to calculate that number.

Moderator: The next question is from the line of Amit Murarka from Deutsche Bank. Please go ahead.

Amit Murarka: Just wanted to check on the volumes that you have done for the quarter for Urea, DAP and all that. I know trading will be a smaller number.

Anil Kapoor: You want to know the production numbers of Urea?

Amit Murarka: I mean basically production and sales.

Anil Kapoor: Sale is 5.80 lakh tons of Urea.

Amit Murarka: And production?

Anil Kapoor: And production is 5.68 lakh tons of Urea.

Amit Murarka: And the trading thing?

Anil Kapoor: DAP & NPK, we have sold 3.27 lakh tons and MOP is 0.79 lakh tons.

Amit Murarka: And specifically can you tell me the DAP number?

Anil Kapoor: Bulk of it is DAP, very small amount of NPK. Approximately 7000 tons of NPK.

Amit Murarka: And on this one-off item that has been reported in the quarter. I mean on other expenses as well as other income, so can you please help me understand as to what was it about?

Abhay Baijal: Amit, if you see the note no. 3, what happens is that since we have a policy to hedge most of our foreign exchange exposures, there are two movements which happen under the standard. One is that you record the mark-to-market against yourself or for you under the other income category and you record the exchange rate variation in the other expenses category that is in the result. So, basically what has happened this time, because the foreign exchange was favorable, the mark-to-market was against us and because it was against us we have to debit about Rs. 33.64 crores and at the same time we took a benefit of about Rs. 32 crores in other expenses. So it basically evens out. But this is how we are representing it in the published results.

Amit Murarka: So, this is basically more for accounting purposes then?

Anil Kapoor: It is basically an accounting methodology. We run our company with approximately 90-95% of fully hedged position.

Moderator: The next question is from the line of Gauri Anand from Old Bridge Capital. Please go ahead.

Gauri Anand: Sir, just on this gross margin expansion this quarter, is it to do with mix change or is it to do with low cost inventory liquidation? This was my first question. The second question is what are the thoughts on the subsidy backlogs. I mean for the industry because before they move to DBT the understanding was all these backlogs will get cleared? So if you could share or give us an update on this front? And the third is, do you see the urea consumption really go down with government changing the bag size from 50 to 45 kg, that is it. Thank you.

Anil Kapoor: The first one which you have asked is margin expansion. See, the reason of margin expansion is better contribution coming from urea. In this quarter, if you can see, the production number is 5.68 lakh tons. I cannot share with you the exact efficiency but the Urea plants have run at very high efficiency numbers. And that is the particular reason why our margins are higher. Second question was on subsidy. We are fighting with the government on a regular basis to clear the backlog. In Urea, they do have the money. So we anticipate that they will clear our backlogs by March 31st. That is our anticipation. As far as P&K is concerned, the government is trying to make a banking arrangement. If it materializes then substantial amount of P&K subsidy will also be cleared. But bear in mind, what happens is that the moment we start next financial year the banking arrangement gets adjusted from the overall subsidy next year. So P&K problems will continue to persist next year, while urea they have provided enough funds, I do not foresee any major problems. I hope I have answered your questions.

Gauri Anand: Yes, so you are hopeful that your backlog for the industry will get cleared by 31st of March?

Anil Kapoor: Bulk of it. There are so many claims pending from previous years for balance claim for urea, balance claim for DAP, freight bill and then you have got DBT. There is a plethora of bills. So I really do not know how much the government will be able to clear before 31st March. But I anticipate that as far as urea is concerned, bulk of it will be cleared. As far as DAP is concerned, if this banking arrangement comes through then major portion will be cleared, not all. Your last question was?

Gauri Anand: The bag size which has changed from 50 to 45 Kg?

Anil Kapoor: Bag size has not yet changed Gauri. We are still at 50 kg. We have not received any final notification from government as to what MRP will be there on the bag. So, as far as the industry is concerned, we have not even ordered 45 kg bag.

Gauri Anand: And if you may allow this last question sir, so, bulk of your construction is through, so when would you actually start the trial run for your new plant?

Anil Kapoor: Trial run should start in middle of November 2018. Have you people visited the plant? I hope the people who are asking this question have visited some of our plants.

Moderator: We have a follow-up question from Siddharth Mohta from Principal India.

Siddharth Mohta: Sir, government was supposed to announce new energy norm for existing urea plant. So any update on that? Even though our plants are well below that particular norm.

Anil Kapoor: As far as new energy is concerned government has not yet notified anything.

Siddharth Mohta: Government was supposed to implement that from 1st April, 2018 actually. That was the last update I had.

Anil Kapoor: We also understand that is the last update. Government, as we understand, is trying to extend the old norms by 2 years but we yet do not know what is going to happen. So there is a lot of uncertainty on that subject.

Siddharth Mohta: Any scheduled shutdown we are planning for Gadepan-I or II in this quarter or might be in FY19?

Anil Kapoor: FY19, we are planning for one shutdown that would be, as we are planning right now, in the month of February or March 2019.

Moderator: Next question is from the line of Afsha Sayed from Dolat Capital.

Afsha Sayed: Sir, I just wanted to understand we have seen a substantial volume de-growth in DAP sales. So if you can highlight on that?

Anil Kapoor: There is not a substantial de-growth.

Afsha Sayed: Around 30%.

Anil Kapoor: No, as far as Chambal is concerned or industry is concerned?

Afsha Sayed: Chambal sir, because as far as I see on the presentation we have sold around 3.27 lac ton in Q3 FY18 and last year same period it was around 4.66 lakh ton.

Anil Kapoor: Yes, but if you have to see their annual number it is 8.72 lac MT compared to 9.76 lac MT.

Afsha Sayed: So it is a 11% de-growth in 9 months.

Anil Kapoor: This year, our focus has been also on market receivables. We have been very judicious in selling our DAP. What happened with DAP is that the prices went up suddenly. They were ruling at between USD 350 and 360 per ton, and when we were coming closer to October, November, the prices were shooting up to USD 370-380-390 per ton. At that level, at the price of Rs. 20,700 per MT, there were hardly any margins left. So we stopped contracts and we limited our purchase which was our deliberate strategy to protect our margins. And we took advantage of this to get better collection from the market. And that is why you can see our interest costs are substantially lower.

Aksha Saiyed: Got it. And secondly, particularly the DAP international prices which have seen an uptick, so how do you see the trajectory going forward?

Anil Kapoor: It is a million dollar question. We do not know how it will go because what we understand is that some capacities in China will be having environmental issues. So there could be problems on that end. Mosaic has also closed capacity in USA i.e. the capacity which they had bought from CNF industries, they have closed down. So the extra capacity which they have got from Saudi is being nullified by capacity closures. DAP availability could be a constraint next year. So what happens to acid price? what happens to sulphur? it is very difficult to tell at this moment.

Moderator: We have a follow-up question from the line of Amit Murarka from Deutsche Bank. Please go ahead.

Amit Murarka: On the efficiency front, I just wanted to understand that couple of years back the government had provided that one-time Rs. 350/ton increase in fixed cost. At that time, the changes were made in some energy efficiency norms

as well. So, can you just help me understand in the current context as to whether we are talking about a continuation of that changed energy efficiency norm or there is a different set of norms altogether?

Anil Kapoor: No, we are talking of the same energy norms which the government had notified as far as the new urea policy 2015 was concerned. The energy norms were to end in 2018. We are discussing the same. The department is pursuing the matter to extend the old norms by additional two years. This is going to be a cabinet decision. So we do not know how it will go.

Amit Murarka: But I remember, at that time itself the energy efficiency thresholds had been reduced, basically which had capped the efficiency gains. So I mean is there further scope to cut the norms further after that reduction?

Anil Kapoor: I agree with you but the industry had accepted the norm which was given at that time. So having once accepted, if nothing happens before 31st March, the new norms will apply for next year.

Moderator: Well, as there are no further questions, I would like to hand the conference back to the management for closing comments.

Anil Kapoor: At the outset, let me thank all the participants for taking keen interest in this call. Gadepan III, once it gets commissioned, is going to be an interesting phase for Chambal Fertilizers. It is a large capacity, one of the largest capacity in the country and we will be producing approximately 3.4 to 3.5 million tons of urea per annum. So, I personally believe, it is going to have a major impact on the way Chambal goes forward. Thank you.

Moderator: Thank you very much. On behalf of Chambal Fertilisers and Chemicals Limited that concludes this conference. Thank you for joining us ladies and gentlemen. You may now disconnect your lines.