Indo Rama Synthetics (India) Limited Q1 FY 11 Results

Investor/Analyst Conference Call Transcript
August 17, 2010

Moderator: Ladies and gentlemen good afternoon and welcome to the Q1 FY11 results conference call of Indo Rama Synthetics India Limited. As a reminder, all participants' lines will be in the listen-only mode. And there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference call please signal an operator by entering '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Shikhar Kapoor of Citigate Dewe Rogerson. Thank you and over to you, Mr. Kapoor.

Shikhar Kapoor: Thank you, Rochelle. Welcome to Indo Rama Synthetics India Limited Q1 FY11 Conference Call. We have with us Mr. R. S. Singhvi, CFO and President, Mr. Anant Kishore, Chief Operating Officer, Mr. Hemant Sharma, Business Head, Mr. L.P. Soni, Vice President, Finance and Mr. Rajesh Sharma, Assistant General Manager Finance. Before we begin I would like to state that some of the statements made in this call maybe forward-looking in nature. A cautionary statement in this regard has been sent to you earlier. I would now like to invite Mr. Singhvi to give you introductory remarks and share with you the perspective of the performance in the quarter and the year going forward. Over to you Mr Singhvi.

RS Singhvi: Welcome everybody. I would like to thank you all for taking your time and being with us today. I will quickly go through our financial results for Q1 2011 where I would cover the key developments and financial highlights for the period under review after which we will be happy to discuss any questions that you may have in more detail.

The performance in this Quarter was muted due to decline in volumes and an increase in overall cost. However, the domestic market is now improving on the back of increased demand and we expect the prices of our finished goods to be firm. India continues to be the fastest growth market globally on the back of economic growth & low per capita consumption and the Indian textile industry envisages reaching USD 100 billion by 2015.

Just to give you a glimpse of our financial performance for the quarter FY11, our net sales stood at Rs. 584.3 crore, EBITDA was at Rs. 46 crore and net loss after tax was Rs. 12.5 crore. For the quarter our interest cost declined to Rs. 14.6 crore and the depreciation stood at Rs. 37 crore.

I would also like to highlight that we are witnessing recovery in global textile and clothing trade. Countries like India and China are seeing positive export growth from early 2010. Polyester growth is being fueled mainly by (a) technological revolution & cost effectiveness (b) versatility and high compatibility with natural fibre (c) Population growth and decline in cultivating land combined with uncertainty of natural fibre. The price gap between polyester and cotton is widening and good quality cotton is becoming increasingly difficult to source. On the other hand the price gap between polyester and other alternate fibre like viscose/ acrylics are also widening. This may lead to strengthening of polyester demand and prices going forward.

Textile industry is a priority sector for the Government of India and significant investments are being made in the Spinning, Texturising, Weaving, Processing and Garmenting industry. The government is also likely to announce National fiber policy which will offer a level playing field across all fibers.

On the back of our large production base, high- tech and sophisticated plant, coal based captive power plant and improved learning curve of manpower resources, I believe we are well placed to explore opportunities going forward. We continue to see the textile industry to be strong, healthy and this situation is seen as an aberration to the positive and long term growth of this industry. This brings me to end of my discussion and we would now be happy to discuss any specific details or questions that you may have. Thank you.

Moderator: Thank you very much. Our first question is from the line of Amol Rao of Antique Stock Broking.

Amol Rao: Is the first and second quarter supposed to be the best quarter for us in the year because of seasonal demand?

RS Singhvi: Normally, first quarter used to be good but this time because of the rise in prices this quarter has not been good. Our inventory of finished goods has accumulated and the market demand has not been up to the expectations because of which we had accumulated some inventory at the end of the quarter.

Amol Rao: Any reason as to why the market has not performed as per our expectations?

RS Singhvi: Internationally the market has done well but unfortunately the domestic market has not picked up.

Amol Rao: In that case how are we buoyant about future growth? If in the best two quarters of the year we do not have an off-take then how are we going to have off-take going forward? Also the other textiles companies are showing better numbers so are they using other fibers?

RS Singhvi: There is a cycle wherein our customers are doing very well and they are making good profits. If you see the results of spinning companies, you will find that their performance has improved considerably over last couple of quarters. Now, the benefit is gradually coming to us and we have seen that when the customers are already earning and market demand is robust, ultimately this results into improvement in our bottom-line and our volumes. We have started feeling this change with an improvement in our volumes in July and August months and we believe that it will continue to be good in the coming months also.

Amol Rao: Why has the number of units sold in power reduced so much?

RS Singhvi: The sales price for power has gone down substantially. Last year we used to sell power at around Rs. 7.10 and this time the prices have crashed.

Anant Kishore: The main reason was that last time it was election period. Lot of states were going for election so all of them were buying power at whatever rate they were to buy and this time mainly the state governments have stopped selling power at high rate so they restricted their power purchases and that is why the power rates have really crashed.

Amol Rao: What is the rate of power now?

Anant Kishore: The rates are hovering from Rs. 2.50 in the normal hours to around Rs. 4.00 in the peak hours.

Amol Rao: What will be the sustainable rate going forward? Do we expect to operate at these levels of utilization as there are quite a few capacities coming up in Chhattisgarh, Jharkhand and Madhya Pradesh.

RS Singhvi: There are two reasons. This time because monsoon has also played a role. The pre monsoon showers have reduced the demand for the power. In the second quarter also the power demand is less because of extended rainy season. Normally the power requirement is little less in July-September quarter and this time because of the pre monsoon the power requirements have declined furthermore. Our surplus power comes from the diesel generating set. This time the furnace oil rates are also very high because of which the overall economies was unfavorable. We feel that in the coming months when the winter season starts, the power demand will go up with the improvement in the rates..

Amol Rao: Are we operating at 80% level utilization for power right now?

RS Singhvi: Power operations are less than 80% level.

Amol Rao: Do we hope to pick up going forward?

RS Singhvi: Yes, going forward it should improve. From September-October onwards the off-take of power normally improves.

Amol Rao: What is our debt (long term) right now? How much is due for repayment in this year?

RS Singhvi: Our long term debts debt is around Rs. 669 crore. Total repayments due are Rs 124 crore in this year.

Moderator: Thank you Mr. Rao. Our next question is from the line of Rohit Singhania of Dimensions Capital. Please go ahead.

Rohit Singhania: On the power business are we planning to expand capacity going forward? What are the plans ahead?

RS Singhvi: Not much of capacity expansion is in the offing. We might generate some more power by putting some balancing equipment.

Rohit Singhania: What is our cost of generation per unit?

RS Singhvi: We have got two kinds of power, one is based on coal, and one is based on DG. So the DG-based power is close to Rs. 5.80 to Rs 6.00 and coal based power is close to Rs. 2.75 to Rs. 3 depends upon the coal availability and its cost.

Rohit Singhania: You mentioned the price at Rs. 2.50 or Rs. 3 at the day time, so we are not selling power to that in that case?

RS Singhvi: No, first of all we consume our power in our own plant and then we sell whatever power is available out of the coal generated power. So we are not selling any power at this rate.

Rohit Singhania: Is the debt level been reduced during the QoQ basis as there is some decline in the interest cost?

RS Singhvi: Yes, debt level is continuously coming down.

Moderator: Thank you. Our next question is from the line of Pankaj Choksi of GC Investments. Please go ahead.

Pankaj Choksi: I have observed that the sales volumes of the polyester business are almost down by 15% compared to last year. Is it that the market off-take of polyester is down so much, or what exactly is it?

RS Singhvi: Last year the first quarter was extremely good in a sense that it was the time when the economy has started recovering from the global meltdown. So the moment economy started picking up, the pipeline started filling up and the volumes had gone up. That was a better than normal quarter in the last year because of which our volumes were pretty good. This year, the pipelines were not empty, it was a routine kind of requirement but in this quarter the volumes have gone down more than the normal, because of which the inventory has accumulated with us and which is now selling in this quarter. These cyclical changes are not very uncommon in a polyester business.

Pankaj Choksi: Is it not typical, the first quarter being good as every year you have done more than 100,000 tonnes in the first quarter.

RS Singhvi: Yes to that extent you are right. This quarter has not been good because of which we had to accumulate our inventory but I think the second quarter will cover up the gap of the first quarter. We have already liquidated the accumulation of inventory and we hope that the volumes will improve in the coming quarters.

Pankaj Choksi: What are you targeting in terms of total sales volumes this year?

RS Singhvi: Presently, we are operating little above 70% capacity and we hope that capacity utilization will improve gradually quarter after quarter and our performance will be better than the last year's performance.

Pankaj Choksi: What will be the total borrowings on our books on your debt as of June including working capital?

RS Singhvi: Our total borrowing as of June including the working capital is around Rs 898 crore.

Moderator: Thank you. Our next question is from the line of Miten Lathia of HDFC Mutual Fund. Please go ahead.

Miten Lathia: Could we put a number to the inventory that we accumulated in Q1?

RS Singhvi: Accumulated inventory is to the extent of about Rs 177 crore in the form of finished goods.

Miten Lathia: In terms of tonnages?

RS Singhvi: It has gone up to 26,142 tonnes in total which is normally around 10,000 to 12,000 tonnes.

Miten Lathia: How much would be Forex debt out of the Rs 898 crore of total debt that you mentioned?

RS Singhvi: Forex debt is around Rs 522 crore including buyers credit.

Miten Lathia: The quarterly Forex gains and losses that we see, is it entirely on account of the debt on the books or is there an operational aspect to the Forex fluctuation also?

RS Singhvi: It is nothing to do with the debt. Debt variations go in the balance sheet.. This is mainly operations. Because we are importing a lot of raw materials together with exporting finished goods exchange fluctuations plays an important role and the variations in the Forex rate and Forex variations have been very wild in the recent past so it is because of the operations that we have incurred this loss. The major part of the losses is on MTM basis. If rupee appreciates, the losses shall be reduced accordingly in our financial statements.

Miten Lathia: So in that case all Forex gains and losses should be treated as totally operational and not as exceptionals?

RS Singhvi: Yes, right but it is mainly on MTM basis.

Miten Lathia: What is the viability of exports in the current cycle as we stand today? Do you think we can push volumes into the export market meaningfully this year or that is not something that you think is possible?

RS Singhvi: Of late the export margins have improved. Earlier, we used to export to utilize surplus capacity but now exports are earning pretty decent margins and our effort is to grow the export besides the domestic volume.

Miten Lathia: Out of our total 3.5 lakh to 4 lakh tonnes output sales target this year, how much would go into exports?

RS Singhvi: Exports are presently 25% of our total capacity. We feel that this trend will continue in the coming quarters.

Miten Lathia: Given that cotton prices have moved up very sharply, do you think the total margins will improve substantially over the next couple of quarters or do you think the Q1 tolling margins are representative of full year numbers?

RS Singhvi: The way the cotton prices are increasing, and availability of cotton is so restrictive, we feel that ultimately the polyester will get the benefit of this scenario. Polyester demand will increase and if demand increases then the margins are bound to go up. We feel that polyester margins and volume will increase because of the shortage of cotton at global level.

Miten Lathia: On a blended basis or on a POY, PSF separated basis, what sort of total margins do you think is possible given the phase of the cycle that we are in?

RS Singhvi: We feel that present margins are going to go up. There is no additional capacity for PSF in the coming years, so whatever additional demand will come that will improve the margins. We feel that PSF will give us better margins in the coming months and coming quarters. For POY some capacities are coming up, but POY demand is gradually increasing because a lot of texturizing machines are being put up in the country and those machines will require POY. So we feel that POY margins are also likely to improve though a bit slowly.

Miten Lathia: If you think margins will improve then why would the full year capacity utilization stay at 70%?

RS Singhvi: I never said that our utilizations will not improve. I said that presently we are running at 70% and gradually the utilization levels will go up. By the year end our capacity utilization will be much higher than the present level. So this will automatically improve the performance as well as the overall profitability of the Company.

Miten Lathia: On our raw material requirements and our export orders, do we operate on a currency hedging basis or do we keep it open till the time receivables come and payables become due?

RS Singhvi: That depends upon the market situation and our understanding of the foreign exchange market. We do take calls at appropriate time to safeguard our profitability and we hedge appropriately ourselves as per the prevailing view at that point of time.

Miten Lathia: In the last two or three years you have lost more money on the Forex than we have gained. Would it not be very natural that if we are in a tolling business we should just cover our Forex exposure whenever that arises, that will protect our margins better than what we are doing right now?

RS Singhvi: As I said that we form our own view of the situation in the Forex market and at appropriate time we hedge our imports and exports and then we try to protect our margins accordingly. Sometimes the wild fluctuations in the market are in nobody’s control and we also have to face the vagaries of the wild fluctuations in the currency market.

Moderator: Thank you. The next question is from the line of Rahul Mehta of Lucky Securities. Please go ahead.

Rahul Mehta: We understand that China which is a big exporter of POY and polyester yarn has kind of reduced the exports because of domestic consumption and Indian exports have started going up. In fact we also understand that some of the Indian exports are heading towards China. Is there any substance to this and if you could just explain that broad situation?

RS Singhvi: There are a couple of factors which are affecting China's export potential: their cost of production is consistently going up and they have withdrawn partially the export benefits which they were offering earlier. Also their currency is now hardening and the government is constantly indicating about the hardening of the currency. So they are not able to be that competitive which earlier they used to be. This has started benefiting India and Indian exports are gradually going up and catching up in the market. So the Indians are exporting more and we are in a better position than China as of now. About our exports heading for China, I have no knowledge about PSF, POY heading for China. Maybe small quantities or some specialty products might have been exported, but so far I have not heard about large exports to China for these products.

Rahul Mehta: As far as your cost competitiveness with China is concerned, besides currency, does labor play a big role in your cost competitiveness?

RS Singhvi: Definitely labor plays its own role. We have added advantage of lower labor cost than China. Although the labor cost in our overall production is not very high as a percentage but then every penny counts when you go to international market.

Rahul Mehta: You just mentioned about some export rebates that they were receiving which have now been stopped. Could you just give us a sense of the quantum of those rebates?

RS Singhvi: They have partially withdrawn some of the VAT rebates. Earlier the rebate on local VAT for exports was around 16% to 17%, which has now been withdrawn partially. This may have put some pressure on the cost benefits because of which they are now concentrating on the domestic market and export markets are very competitive which will help to Indian exports.

Moderator: Thank you Mr. Mehta. Our next question is from the line of Naga Deepika of Capital Market. Please go ahead.

Naga Deepika: Why have the revenues from power and polyester segment come down in this quarter?

RS Singhvi: The power rates have been very low in this quarter because of which it was not remunerative enough to sell power and also the cost of power generation has increased. We normally sell our diesel engines power in the market. The increase in the polyester inventory consequent to the less than expected demand has reduced the revenue from polyester segment also.

Naga Deepika: Do we have a power plant?

RS Singhvi: We do have a power plant but that is primarily used for captive. We have diesel generating sets which we utilize when the right opportunity comes.

Naga Deepika: Can you just give us overall breakup of the revenues and how much was the contribution to the total sales?

RS Singhvi: The overall break up of net revenue (aggregating to Rs 625.07 crores) between polyester and power is Rs 564.23 and 60.84 crores respectively in Q1.Our EBITDA was 8% in QI whereas last quarter the EBITDA was 13%. Primarily this is because of the lesser volumes and also the power sector has not performed well because of which our overall results were muted as compared to last year.

Naga Deepika: What is the bottom line of the management in selling the DG generation power and not the coal generation? Why can't we expand our 30 MW capacity and start supplying power for the coal and stop DG because DG is obviously higher than the coal generation energy?

RS Singhvi: Yes, you are right that DG power is expensive and coal power is cheaper. We are putting up some balancing equipment to generate more power out of coal and we are contemplating making some small investments into generating more coal power but as of now coal power generation will not change to larger extent. Regarding DG power I would like to say that at least six to seven months during peak load hours in a year we do sell the DG power particularly in the peak winter and summer. The DG power also contributes to some extent. There are also times when the DG power is not economic to sell like the rainy season.

Naga Deepika: Where do we get the coal from for our captive power generation?

RS Singhvi: We source it from WCL (Western Coal Fields) which is very near to our plant: about 200 to 300 kms and we have got the coal quota which is given by the government, so that coal is cheaper than the normal market coal.

Naga Deepika: Is the full coal consumption will be from WCL and coal quota? Do we not import anything?

RS Singhvi: 80% of the coal consumption is from quota and around 20% we have to source from market. We do not import because we are not near to the port and so it does not make any economy for us.

Naga Deepika: What is your outlook for margins going ahead, particularly for polyester? Also can you give us the outlook for polyester and power front for FY11?

RS Singhvi: The alternate fiber prices are rising. Like cotton, viscose, acrylic, the prices are surging ahead. We feel that this will result into the improved demand of the polyester and thereby improve margins of the sector. So going forward margins as well as the volumes in the polyester segment will definitely improve and power segment will also do better. Normally, the power demand starts from October till March. So the power segment will also do better than what we have done in the recent past. Performance wise we will be improving in the coming quarters.

Moderator: Thank you, our next question is from the line of Nilesh Doshi of Techno Shares please go ahead

Nilesh Doshi: How sensitive is the polyester market with respect to the cotton yarn? Is it easy for the users to shift past to polyester if the cotton yarn prices for further go up?

RS Singhvi: Cotton yarn is primarily for export and India is the largest cotton yarn exporter around the world. Globally there is high demand of cotton yarn and the availability is very less so cotton yarn is always in demand and whenever the price rise they do get enough compensation for that. The polyester yarn is primarily used in the domestic market and some part is also exported but 80% of the yarn is consumed domestically. Shift in the capacity from cotton to polyester do take place when the availability remains a question mark. We feel that this year is going to be good and we are going to gain some capacity from other fibers because of their continuous rise in prices. We do feel that this time there would be some shift from cotton to polyester or viscose to polyester or acrylic to polyester and it will improve our volumes as well as margins.

Nilesh Doshi: Does that mean that the consumers do shift to the blended fast if the cotton prices go up?

RS Singhvi: Yes. At times the price point comes to a level where consumers ultimately shift. When you go to a mall and find that a shirt which was of Rs. 500 a piece is now selling at Rs 700 then you end up shifting your requirements to other brands and you may shift accordingly. So price point plays an important role.

Nilesh Doshi: How do you see for the yarn manufacturers to shift from the cotton yarn production to the synthetic?

RS Singhvi: Suppose the cotton prices goes up abnormally and the yarn prices are not compensating that increase in the cotton fiber then ultimately they tend to shift to the other alternative fiber and the alternative fiber availability is only polyester as of now. We do feel that certain capacities will take a shift in this year from cotton to polyester.

Nilesh Doshi: Even the Chinese consumers do shift from to the blended if the prices go up?

RS Singhvi: This is a global phenomenon. Although China is importing lot of cotton but we have already reached near to the all time high prices of cotton in international market. How far can this sustain and how far the prices of the finished goods can go up .Mr. Vij would like to comment on the same.

R.K. Vij: Whenever the cotton prices are higher and polyester prices are lower the people shift between the PC blend, like from 55-45 to 65-35 which means 55% cotton and 45% polyester to 65% of polyester and 35% of cotton. Now these machines and equipment are also the same. People can run on the same machine for the cotton and polyester cotton both. Cotton has gone up to Rs 33,000 per candy whereas polyester is steady at Rs. 68.25 per kg without excise duty; viscose is at Rs 122 per kg whereas our cotton is at Rs. 100 per kg. Now automatically people will shift from cotton to polyester cotton blend and a richer polyester blend which will give boost to the demand of the polyester.

Nilesh Doshi: Even these dynamic changes very fast. For example in this case the moment polyester consumption starts rising the cotton yarn prices can start coming down to compensate for the loss of business.

RS Singhvi: Given the options this would happen, but the question here is that cotton availability is a question mark, so if cotton availability is not there than there is not case for reduction in cotton prices.

Nilesh Doshi: Indian cotton availability is extremely high in the current season.

RS Singhvi: When we evaluate the cotton scenario we have to evaluate it globally because India is the second largest exporter of cotton and India is a very big player of cotton export. Globally the demand is more and supply is less. That is a point where the polyester will gain out of the whole scenario.

Nilesh Doshi: That means we see a good quarter going ahead for polyester? We should be back to at least 12-13% margin level as we go forward?

RS Singhvi: Ultimately it will reach to that level & gradually inching up has already started.

Moderator: Thank you. Our next question is from the line of Ashwin Kedia from Alchemy please go ahead.

Ashwin Kedia: Do we have any plans to increase the capacity utilization of the plant?

RS Singhvi: Yes, we do have plans to increase the capacity. The capacity is likely to improve gradually in the coming quarters. As of now we were having some inventory with us accumulated from last quarter so this quarter we are liquidating all acquired inventory and now the capacity utilization will go up when we do not have any inventory in the pipeline and demand is improving.

Ashwin Kedia: In the last 2-3 years there is a major loss on the part of the Forex in your balance sheet. Do you have any plans or schemes that you don't have the Forex losses this year?

RS Singhvi: Forex loss is not in our hand. When we import and export, we cannot get away from the vagaries of the situation but at the same time we have got various tools to protect our interest and which we are doing. In the recent past you must have seen that the dollar-rupee parity has been changing from Rs.

44.52 to Rs. 47 in no time. This situation alters the whole equation many of the times. We are taking all protective measures but still when there are such wild fluctuations and quick changes in the parity then sometimes you have to incur some losses and sometimes you gain also from the situation. We feel that going forward we will be able to protect our interest.

Ashwin Kedia: How do you foresee the polyester prices as well as the PTA prices in the next quarter?

RS Singhvi: It is difficult to forecast PTA pricing because it is a derivative of crude & also the demand & supply balance and as you have seen that crude prices have moved from $70 to $82 in like 10 to 15 days' time and then its again back. Given this band we feel that PTA prices will remain stable. We feel that the margins in the polyester segment will go up and our prices will also increase.

Ashwin Kedia: Are you using 100% imported PTA or are you also using the domestic PTA?

RS Singhvi: We have domestic tie ups with the PTA suppliers and also large quantity is imported.

Moderator: Thank you. Ladies and gentlemen that was the last question. And I hand the conference over to the management to add closing comments please go ahead

RS Singhvi: Thank you everybody for sparing your valuable time and joining with us. If you still have any questions you can always e-mail to us and we will be happy to respond to your queries. Thank You.