Dhampur Sugar Mills Limited

Q2 & H1 FY2012 Earnings Conference Call Transcript

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Moderator: Ladies and gentlemen, good afternoon and welcome to the Dhampur Sugar Mills Limited earnings conference call. As a reminder, for the duration of this conference, all participants' lines are 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 pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. At this time, I would like to hand the conference over to Mr. Ishan Selarka. Thank you and over to you.

Ishan Selarka: Thank you, Laveena. Good afternoon and welcome to Dhampur Sugar Mills Limited's Q2 & H1 FY12 earnings conference call. Today, we have with us on the call Mr. Gaurav Goel – Managing Director, Mr. Gautam Goel – Managing Director and Mr. Arhant Jain – Executive President, Finance from the Company. We will commence this call with opening remarks from Mr. Gautam Goel and Mr.Gaurav Goel, following which we will have an interactive question-and-answer session.

Before we begin, you may want to know that some of the statements made or discussed in the conference call may be forward-looking in nature and a note to that effect was stated in the release and concall invite sent to you earlier. I would now like to invite Mr. Gautam Goel to share with us his perspective with regards to the Company's performance during the quarter and half year ended September 30, 2011 and the opportunities going forward. Over to you, Gautam.

Gautam Goel: Thanks, Ishan. Good afternoon and a very warm welcome to all at Dhampur's Q2 & H1 FY12 earnings conference call. I would like to begin by sharing my perspective on the Sugar sector while discussing the Company's operational performance following which, Mr. Gaurav Goel will take you through the financial highlights of the Company for the second quarter and half year ended September 30, 2011.

To begin, there was an upswing in sugarcane production in the country during the sugar season 2010-11 from 17.2 million tonnes to 24.3 million tonnes. With demand of over 22 million tonnes, the Government of India permitted Sugar export of about 3 million tonnes of Sugar. Out of this, 1.5 million tonnes of Sugar was to be exported in three tranches under the Open General License; approximately 1 million tonne under the Advanced License and 0.5 million tonne under the re-export of raw sugar program. Despite this, we go to the coming season, with an opening inventory of approximately 4-4.5 million tonnes. Going into the next

Sugar season, we expect the cane crushing to be higher by about 5-10% driven mainly by adequate rainfall, rise in cane acreage and improvement in recovery rate which would, if all goes as per plan result in Sugar production in between 25-26 million tonnes. Also, you would be aware that the state government has increased the cane price from Rs. 205 per quintal in U.P. to Rs. 240 per quintal. The increase in cane price will significantly increase the cost of production and is likely to impact the earning performance. We hope the government would take adequate steps to reduce the demand -/supply gap through various policies such as permitting exports, etc. Also, the export of Sugar would enable cane payments and Indian mills will have an opportunity to realize good margins on exports. Additionally, there are fresh talks about decontrol in the Sugar sector. We believe that a situation of surplus sugar in an opportune time for decontrol and it will check the cyclical nature of the Sugar production. Currently, two key areas that need to be considered for decontrol are levy sugar obligation and the monthly release mechanism**.** Any rationale development on any or both of these would improve the performance of the Sugar segment.

To give you a broad outlook on crushing, it started on the 2nd-3rd week of November 2011 and we expect recovery rates to be better than last year. In terms of realizations, current domestic realizations are upwards of Rs. 30,000 per tonne while the international prices are standing for in the range of USD 600-700 per tonne given the lower Brazilian output by 5%.

I would now like to request Mr. Gaurav Goel to take you through the balance part of the opening remarks. Thank you.

Gaurav Goel: Thank you, Gautam. Top-line growth in the Sugar segment has been subdued due to lower volumes as the Company during the corresponding quarter of last year had processed and sold raw sugar which was not done in the current quarter. Average free sale Sugar prices during the quarter and half-year ended stood at Rs. 28.76 per Kg and Rs. 28.73 per Kg. The Company in Sugar season 2010-11 crushed 33.1 lakh tonne of cane compared to 32.74 lakh tonnes of cane in the previous year. Sugar recoveries were marginally higher at 9.34%. These factors resulted in the total production of 3.09 lakh tonnes of Sugar in the last year. The total inventory as on 30th September, 2011, stood at 0.64 lakh tonnes of Sugar comprising of free sale and levy sugar at an average cost of Rs. 24.54 per Kg.

On the power side, we have seen healthy growth in Q2. During the quarter and half year period, Dhampur in its Power segment generated 2.39 crore units and 8.12 crore units of Power and exported 1.84 crore units and 6.22 crore units. The average price for the quarter stood at Rs. 4.67 per unit to Rs. 4.79 per unit in Q4 of FY2011. For the six months period, Power realization stood at 4.62 per unit. We believe that the enhanced availability of bagasse in this coming year due to higher availability of sugarcane will enable us to run our power plants for more days in the off-season which would have a positive impact on the earnings performance of our Power business.

Our Chemical and Ethanol division delivered better performance as a result of reduced raw material price and improvement in production and sales volume at a higher price. The Company during the quarter and half year ended sold 25.84 lakh Kg and 52.58 lakh Kg of chemicals at an average price of 54 per Kg and 52.74 per Kg respectively. The Company also sold 85.76 lakh bulk liters of RS, ENA and Ethanol at Rs. 26.39 per bulk liter during the quarter and 123.14 lakh bulk liters at Rs. 26.52 per bulk liter during the six months ended 30th September.

I would now like to take you through the financial performance of the Company. Our total revenues for the quarter and half-year stood at Rs. 407 crore and Rs. 658 crore. As mentioned earlier in the call, top-line was lower due to lower Sugar revenues. However, despite lower revenues compared to the corresponding period last year each of our business segments recorded positive margins. Our interest cost during the quarter increased to Rs. 28 crore. This increase is attributed to higher utilization of working capital combined with a rise in interest rates. Also, forex loss on our ECB also enhanced the interest cost. For the quarter and half year ended September 30, 2011, Profit after Tax stood at Rs. 4 crore and Rs. 5 crore respectively.

Moving on to our balance sheet, the term debt as of 30th September, 2011 stood at Rs. 488 crore compared to Rs. 523 crore in the same period last year and Rs. 496 crore as of 30th June 2011. Revenues from the Sugar division stood at Rs. 364 crore during the quarter as compared to Rs. 467 crore in the corresponding quarter last year. The Company had processed and sold raw sugar last year which was not done in the current quarter. For the half year Sugar sales stood at Rs. 581 crore. The Sugar segment contributed 87.4% to the sales in Q2 FY12 compared to 92% in the corresponding period last year. Despite lower volumes, this segment reported improved earnings performance.

During Q2 FY12, Power sales were higher at Rs. 16 crore as compared to Rs. 14 crore in the corresponding period last year. For the six months period, Power sales stood at Rs. 47 crore. PBIT for the quarter stood at Rs. 2 crore compared to a loss of Rs. 1.1 crore in the corresponding period last year. For the half-year ended September 30, PBIT stood at Rs. 4 crore.

Revenues from our Chemicals business for the quarter were higher by 33% at Rs. 37 crore and for the half year period top-line stood at Rs. 61 crore. PBIT for Q2 swung from a negative of Rs. 8 crore to a positive of Rs. 4 crore as a result of reduction in raw material cost vis-à-vis last year and improved earnings from Ethanol and Ethyl Acetate. Going forward, we continue to focus on targeting business opportunities from the Chemicals Ethanol and RS segment that offer better margins.

These on a broad level were our financial numbers. Thank you once again for joining us on this call. We will be happy to answer any questions that you may have.

Moderator: Thank you very much sir. We will now begin the question and answer session. The first question is from the line of Achal Lohade from JM Financial. Please go ahead.

Achal Lohade: As you said that the state government has increased the cane price and we read from news articles that the U.P. Sugar Mills Association has already filed a case and the hearing is on 22nd of

November. Just wanted to get your sense as to how do you see this issue? Have our mills already started and what cane prices are we paying to the farmers?

Gaurav Goel: Case has been filed as you have heard. The first hearing happened today and the next hearing is scheduled for next Tuesday. We are hoping to get some sort of a favorable judgment from the High Court on this year's cane price. Two of our factories have started but we have not made any cane price payment as of now.

Achal Lohade: What if we do not get any interim relief? Till that point in time do we need to pay them Rs. 240? Also, have we seen other mills actually delaying the start of the operations?

Gaurav Goel: As of now, most of the factories in the western part of U.P. have started their cane crush. As of now, we have 14 days from starting of our factories to making the first cane price payment. Obviously, if we do not get any order from the court, then we will have no option but to pay this SAP of Rs. 240.

Achal Lohade: From the industry point of view do we see that banks have been reluctant to provide the working capital this time around because of the losses we are seeing in the Sugar segment?

Gaurav Goel: From the Company's point of view, we will have not faced any sort of issues on that account but from some of the other players we all are hearing some news that the banks are a bit hesitant to give more working capital. So your point is quite right that there might be some issues on being able to make this cane price payment as we reach early next year.

Achal Lohade: Do you see that this is far more severe for Maharashtra and Karnataka cooperative mills than the northern mills or you think it is even equally bad in actually cooperative or the government-owned mills in northern states like U.P.?

Gautam Goel: In the cooperative sector, down south, basically the problem is funding. We understand Maharashtra Cooperative Bank which used to be the main funder for the cooperative sector and had some financial crisis and RBI stepped in over there. From what we hear, there is a severe cash crunch in the cooperative sector in the western part of India. In northern India, I guess it will depend on the balance sheet and the overall business environment. Of course, companies which have a better product portfolio could probably be a little bit better than the companies which are fundamentally more focused on Sugar.

Achal Lohade: What is the average cost of borrowing for working capital at the moment and cost for total debt

Gaurav Goel: Our average for working capital is about 12.5% and for total debt, our average cost is about 9.75%.

Achal Lohade: How much is ECB out of this?

Gaurav Goel: ECB is only USD 10 million out of our total term debt, balance is all Indian debt.

Achal Lohade: We get to hear a lot of different numbers actually for the consumption side. Sometimes we get to hear 22 million tonnes, 23 million tonnes as high as 23.5 million tonnes. What is our sense as to what was the realistic assumption, how much exports do we see government allowing and by when do you see that is happening?

Gautam Goel: On the part of the exports, we understand that the government in principle made up its mind to permit 2 million tonnes of exports. First tranche should be coming out in **the GOM** scheduled for Monday. We are expecting anything between 0.5 million tonne to 1 million tonne. On the consumption numbers, one aspect to look at the consumption number is so-called official release of the Government of India. As per Government data it is about 22-odd million tonnes. Consumption numbers could range anywhere between 22.5 million tonnes.

Achal Lohade: I am just trying to figure out as to how much export do we see in, since we are looking at a second year consecutive increase in the production. Do we see that this could be the peak and next season could we start seeing decline in production trend, do we see that happening that farmers are shifting to other crops from sugarcane?

Gautam Goel: The only reason which will make the farmers shift would be the cane price arrears. Cane price arrears will be a function of the domestic price which I guess will be a function of what the international markets are doing and the export policy. If you say the domestic prices have fallen sharply that would obviously result in a cane price arrear. There is no way that cane price arrears are pretty much a lot of it and they cannot get avoided. That should have an adverse effect on the planting. A lot of it will be dependent upon how proactive the government is going to be when you look at exports, when you look at doing away with the levy sugar, maybe just like this. A lot of it will depend upon Government of India with regards to the stability and production for the future years.

Achal Lohade: I think one another aspect could be some measures on the decontrol front, especially the levy and the release they carry upfront.

Gautam Goel: If they do away with levy, that will be a positive from the cash flow perspective. If they do away with the release mechanism on the short-term it could result in prices being lower.

Moderator: Thank you. The next question is from the line of Ajay Nandanwar.

Ajay Nandanwar: What were your Sugar and Ethanol realization this quarter?

Gaurav Goel: Our realizations were Rs. 28.7 per Kg for free sugar Rs. 26.39 per Kg for Ethanol/RS during the quarter.

Ajay Nandanwar: What was the levy mix for H1?

Gaurav Goel: For H1, if we take a total mix, we realized an an average of Rs. 27.78 per Kg.

Ajay Nandanwar: With higher SAP, what Sugar and Ethanol prices would you need for EBIT breakeven?

Gaurav Goel: For an EBIT breakeven for Dhampur, because of our Power and Ethanol that we have got, an ex-mill price of Rs. 29 will help us achieve break even at an EBIT level.

Ajay Nandanwar: Rs. 29 for Kg sugar and Rs. 27 for Ethanol?

Gautam Goel: Yes.

Ajay Nandanwar: On the Sugar, Ethanol and Power?

Gaurav Goel: Yes. On the Power side we will still earn money because the transfer pricing of bagasse has been assumed at a certain price. So I am just talking about the sugar side right now, but on a Company side it can be slightly lower because at that price, we will still be making money from our Power side.

Ajay Nandanwar: How much money will you make on Power per unit?

Gaurav Goel: As of now depending on our total cane crush that number will change because of the amount of bagasse and there would also be some stock for the off-season. We will share the number with you perhaps after March.

Ajay Nandanwar: When you say Rs. 29 per Kg, what kind of yield you are assuming?

Gaurav Goel: We are assuming an average recovery for the group to be at 9.35%.

Ajay Nandanwar: So what is your view on the yield for this year and next year at sustainable level, where do you think U.P. yield can be and we can talk about western U.P. separately?

Gaurav Goel: Cane yield or recovery yield?

Ajay Nandanwar: Recovery.

Gautam Goel: In U.P., western U.P. has not been very encouraging for the last few years. Of course, a lot of effort is happening in the cane planting area, but it is a little premature to say as there are so many agro-climatic factors. But one thing is for certain that western U.P. will continue to remain lower than the central and eastern U.P. We have only about 25% of production coming from western U.P. which is the lowest recovery zone. And some of the higher recovery zones in U.P. like central U.P. where close to 40% of our production comes around. On that factor, we seem to be fortunate that our average recovery seems to be in the top 5-7% in the situation.

Ajay Nandanwar: Your current Sugar prices are slightly higher than Rs. 29.

Gaurav Goel: But then out here as of now, Ajay, we have to keep one thing in mind that these prices are only temporary because the sugar mills started late in Maharashtra. But for surely, if India is expected to produce 25-26 million tonnes and there is not a shot on export policy, then these prices can come down drastically. So we were not also seeing a just from a one-month perspective but from a 12-month perspective.

Ajay Nandanwar: How much do you think India would have to export given a situation that the country produces 25 million tonnes, to maintain prices?

Gaurav Goel: 2 million tonnes. If India produces 25 million tonnes, the issue is whether we produce 25 million tonnes or 26 million tonnes and the export also a lot of it will depend upon and what is the timing of the exports. If you allow this stuff to get built up then it will put a lot of pressure in the domestic market. Government is in principle, from what we understand, has taken a decision to permit 2 million tonnes of exports, now but if there is some dilly-dally and the government does not allow the timely export of Sugar, then that could depress the 2 million tonnes of sugar export.

In a scenario where you have 26 million tonnes, you could export another 1 million tonne of sugar. But the timing is a crucial aspect. If the proactive policy allow sizeable exports from now onwards that could potentially prevent prices from falling down too sharply. The balance will depend upon how the release mechanism is done.

Ajay Nandanwar: How was the export allowed last year?

Gaurav Goel: Export basically has 1 million tonne was against pending ALS of previous year, 0.5 million tonne was re-export of raws which had been brought in to the factory and 1.5 million tonnes was under OGL. As of now this 1 million tonne which is being spoken about immediate export is expected to be under OGL.

Ajay Nandanwar: When you sell the OGL quota to Maharashtra and Karnataka mills, how much do you get per Kg?

Gaurav Goel: It varies a lot, Ajay. Depends on what is the global price at that point of time and the India price and on that there is an arbitrage. So as of now we really do not know the price of that.

Ajay Nandanwar: The sale of free sale of sugar you talked about price of Rs. 28.7 per Kg, this includes the OGL?

Gaurav Goel: No.

Ajay Nandanwar: In addition, have you got some OGL?

Gaurav Goel: Yes.

Ajay Nandanwar: From what you are saying, if the current prices of Sugar are at this price about Rs. 29 and you also have a benefit of OGL maybe some 25 or 20 paise or so per Kg, why did not the court would be sympathetic to your case?

Gaurav Goel: I would say the point is that in case you show me a price of Rs. 30 per Kg through the year, I have no issue in paying this price. But then the whole point is that my sugar is going to be priced as per the market while my cane price is fixed. So there is no one as of now with the present opening stock and with the expected India should produce who will say that these prices can sustain. So that is the whole point out here. As we have always said is that you link cane price to sugar price and we have no issue in paying a high cane price. The whole point is that it is better for sugar mills to pay a higher cane price because that is the only way in which farmers will grow more cane. So we do not expect this price of Rs. 30 to sustain going into the next year. Even last year at this point of time the price of Sugar was at Rs. 31, the new price, every time you have to see historically when the factory start this month, this is the peak of Sugar prices come down over time.

Ajay Nandanwar: What is typically the gap between November and the average yearly realization?

Gaurav Goel: November of last year, our price was at about Rs. 31 per Kg which came down over time to around Rs. 27 and Rs. 28 and at that time when we paid a cane price of Rs. 205.

Ajay Nandanwar: The area average was Rs. 28 per Kg or so?

Gaurav Goel: Yes. So if we see the four quarters that is when you average of say Rs. 28.5 to Rs. 29 and that is for Dhampur in which half of our Sugar is refined Sugar. For every other Sugar mill they have only got regular Sugar which came at lower price than refined Sugar.

Ajay Nandanwar: Perhaps the price of sugar depends on the Rupee/Dollar exchange rate too, depending on how much import/export is allowed, do you consider Rupee forward cover as a hedge for your business? Because especially currently it is at significant premiums you can sell Rupee at almost Rs. 53 now per dollar.

Gaurav Goel: But that will only be of an advantage in case you are exporting sugar. Otherwise, no one really does that because of uncertainty about the government policy. So we will not like to speculate on that by taking a forward cover on the INR.

Moderator: Thank you. The next question is from the line of Ashi Anand from Kotak. Please go ahead.

Ashi Anand: If we just go back historically and look at the seasons where actually cane arrears have actually gone up significantly, we have seen at times even in 2004-2009 where production in the following year actually falls as much as by 30-45%. Now, hypothetically, if the government actually does not come in and allow exports or does not decontrol, etc., and cane arrears would actually go up. Just wanted to understand your estimates in terms of what is the potential decline in if the production that happens and are there particular areas which swing faster than other areas? So say for example, does Maharashtra swing more than U.P., does western U.P. swing faster to other crops compared to U.P. can you give any color on that?

Gautam Goel: We even have done a bit of a study on this and if we see the years 2007-08, 2008-09 and then 2009-10, we have seen Maharashtra go down from 9 million tonnes to 4.5 million tonnes in one year. U.P. has dropped maximum of about 30% in one year. So the drop in U.P. is slightly lower vis-à-vis Maharashtra. Maharashtra, we had seen that they can change their crop very, very fast perhaps because of their advantage of various crops. So I personally believe that yes, in case that the cane price arrears going into Jan to March you can see a drastic drop in sugar in 2012-13.

Ashi Anand: Typically when the drop happens, the drop is likely to be higher in Maharashtra compared to U.P.?

Gautam Goel: That is what we have seen historically.

Ashi Anand: Would this be true for both the sugar seasons?

Gautam Goel: Maharashtra being a lower price, U.P. would sell. Maharashtra only pay Rs. 205 this year.

Ashi Anand: They may not have as much P&L as we would.

Gautam Goel: Rs. 185 to 205. In U.P. also, probably again you see the drop in generally eastern U.P. what they call non-traditional cane areas to be a little bit more than the drop in western U.P.

Ashi Anand: Eastern U.P. tends to drop little more than western U.P.?

Gautam Goel: The big swings come from the eastern and non-traditional belts what we call. It is very difficult to say how much is the arrear in Maharashtra. A lot of it will depend on the Sugar pricing and arrear situation in different regions of the country.

Ashi Anand: Which is why I was just mentioned hypothetically.

Gautam Goel: Exactly. Today, in Maharashtra cost of production is going to be considerably lower than us. In the event something favorable happens in the court, both the U.P. and Maharashtra prices sort of come little closer, but U.P. is basically more efficient processor.

Ashi Anand: How does it play out when say Maharashtra, for example this year you have indicated that the cost of production would be much lower there. So in a market space what really determines the price?

Gautam Goel: It is the ability of the lowest cost producer to sell sugar plus freight cost. Maharashtra is a net exporter of Sugar. The markets which are in Maharashtra has surplus of a sizable quantity of Sugar. Then Maharashtra Sugar would find markets, say up North to Delhi or to Punjab which are normally serviced by U.P. Sugar. But the freight for the Maharashtra Sugar would be higher than the cost of freight from the sugar from up north.

Ashi Anand: If you could just give some kind of indication on freight from Maharashtra on per Kg basis?

Gaurav Goel: The price differential between North India and Maharashtra, normally ranges in about Rs. 100-200 for basic quality and the other factor which will come into play this year again if the export take place then the exports fundamentally the bulk of the exports would take place out of Maharashtra. Let us say if Maharashtra is producing 8.5 lakh million tonnes of Sugar and if India wants to allow 2 million tonnes of export, we anticipate about 1.7 million tonnes should flow out of Maharashtra.

Ashi Anand: Just going hypothetically a bit further, suppose for example government does actually allow exports of Sugar and therefore domestic pricing remain strong this year, and therefore cane arrears would pick up. Given a situation where SAP prices remains at Rs. 240, could this lead to an even greater surplus for next year? Because the Rs. 240 per tonne per quintal sugarcane could possibly become a little more attractive than others crops and therefore lead to even more area under cultivation.

Gautam Goel: We definitely will see an increase in acreage. But to what extent, again it will depend upon competing crops. We have seen like Maharashtra for example, seems to be saturated at about 9-9.2 million tonnes because they do not have more crushing capacity. In North India, what we are seeing is that western U.P. seems to be saturated at about 1.7 million tonnes of Sugar production purely on account of massive urbanization. So U.P. probably could go up by 0.5 million tonnes, another 0.5 million tonnes for the other parts of north India, maybe another 1 million and odd tonnes or something for the other part of India. So even if you see a production going up by a 1.5 million tonnes but above 0.5 to 1 million tonnes, there should be a growth in consumption also.

Ashi Anand: In Bihar we have been hearing of a cane crushing units getting revived and therefore potentially Bihar going back towards being an important cane hub potentially going forward? Any views on this?

Gautam Goel: No, we do not expect this as of now despite 3-4 mills in Bihar restarting. Bihar is still a very small player and even with the 3 or 4 or 5 mills starting you are talking about an additional 2 lakh tonnes of sugar capacity maximum. It will take Bihar at least 5 years to become some sort of a major player in the Indian Sugar.

Moderator: As there are no further questions I would request the management of Dhampur to add a few closing comments here.

Gaurav Goel: Thank you so much. I would like to thank all of you for joining us in this Q2 conference call of Dhampur. If you have any questions, please feel free to contact us on our web site, www.dhampur.com. Thank you once again. Bye-bye.

Moderator: With that we conclude this conference. Thank you for joining us. You may now disconnect your lines.
