“Sharda Cropchem Limited
Q1 FY2020 Results Conference Call”

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CHORUS CALL

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MANAGEMENT: MR. RAMPRAKASH V. BUBNA - CHAIRMAN & MANAGING DIRECTOR - SHARDA CROPCHEM LIMITED
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Moderator: Ladies and gentlemen, welcome to the Q1 FY2020 results call of Sharda Cropchem Limited hosted by Emkay Global Financial Services. We have with us today, Mr. Ramprakash V. Bubna - Chairman & Managing Director and Mr. Ashish Lodha - Chief Financial Officer. As a reminder, all participant 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 the conference call, please signal an operator by pressing "*" then "0" on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Varshit Shah from Emkay Global. Thank you and over to you Sir!

Varshit Shah: Thanks Stanford. Good evening everyone. I would like to welcome the management of Sharda Cropchem Limited and thank them for giving us this opportunity. I would now hand over the call to the management for opening remarks. Over to you Sir!

Ramprakash V. Bubna: Good evening, ladies and gentlemen. A very warm welcome to everyone present here for the earning call of Sharda Cropchem Limited for the Q1 of financial year 2019-2020. Sharda Cropchem is represented by me Ramprakash Bubna, Chairman & Managing Director and Mr. Ashish Lodha - Chief Financial Officer. Talking briefly about our Q1 results, the revenues declined by 7.3% year-on-year from Rs.456 Crores to Rs.423 Crores. Agrochemical business revenue declined by 16.1% year-on-year due to unfavorable weather conditions in NAFTA and European region.

Non-agrochemical business continues to provide robust growth of 36% year-on-year. Gross margin declined by 3.2% from 31.0% to 27.8% mainly due to increase in raw material cost and our inability to pass the same on to the customers. We have been able to curtail our overheads. It has marginally increased by 4% during the quarter. Profit after tax declined by Rs.11 Crores from Rs.34 Crores to Rs.23 Crores in the last quarter mainly due to increased depreciation by Rs.17 Crores during the quarter. The net working capital improved from 117 days to 99 days year-on-year.

The company continues to be debt free and cash surplus. The cash surplus improved by Rs.400 Crores as on June 30, 2019 as compared to June 30, 2018. We had a debt of Rs.163 Crores and a cash balance of Rs.72 Crores in 2018. Now, the cash balance is Rs.309 Crores in 2019. With this brief overview, I would now like to handover the call to our CFO, Mr. Ashish Lodha for discussing the financial performance, Mr. Lodha!

Ashish Lodha: Thank you Mr. Bubna and a very good evening to all. I will give you the brief about the Q1 FY2020 performance. During the Q1, our revenue declined by 7.3% year-on-year. This was due to de-growth of 15.2% in Europe and 39.4% in LATAM. However, NAFTA and the rest of world revenue increased by 18.2% and 5% respectively. Revenue was impacted by negative 4.2% on an account of volume, negative 3.8% on an account of product and price mix, which was partly offset by favorable foreign exchange impact of 0.7%. EBITDA declined by 30.8% year-on-year basis and the EBITDA margin decreased from 18.7% to 14% due to decline in revenue and lower gross margin. Depreciation increased by 92% on year-on-year basis from Rs.18 Crores to Rs.35 Crores mainly driven by higher capitalization of the intangible asset in H2 of financial year 2019. Profit after tax declined by 33.5% from Rs.34 Crores to Rs.23 Crores in Q1 FY2020 on an account of higher depreciation and lower EBITDA. Thank you and now open the floor for the questions.

Moderator: Thank you very much Sir. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Nihal Jham from Edelweiss. Please go ahead.

Nihal Jham: Good evening Bubna Sir, my first question is that at the end of Q4 two months back we were confident of doing a growth in excess of 10% for this year, but obviously the Q1 has not come as per our expectations and I think we have seen a de-growth in sales, whereas the weather conditions that we mentioned was prevailing at that time also, so just want to know your thoughts that has how things incrementally turned worse over these last two months and second do we still expect to do a double digit growth for the year ahead?

Ramprakash V. Bubna: The weather condition has been unexpectedly gone worst in the Q1. There have been very severe problems in NAFTA region very heavy flooding and extended summer, which was totally unpredictable. Similarly, there has been very severe dry conditions in Europe, also not predicted at that time. The next question is about the expectations for the next year, see our Q4 is the most important quarter for us. There has been some de-growth in the Q1, but we are hopeful of making it up and we should be able to touch a double-digit growth.

Nihal Jham: So Bubna ji, just continuing on that, are we expecting any new registration? which is giving us the confidence, or we are hoping that the weather condition or the season, which happens in Q4 will be better for us?

Ramprakash V. Bubna: Both, we are also expecting some new registrations and as you know by the law of natural variation, the weather condition cannot continue to be bad throughout the year, so we do hope that the weather conditions will change.

Nihal Jham: Absolutely Sir, just one last question on this point, our working capital obviously been improving driven by reduction in debtor days, so is there any aspect of curtailing debtors also is leading to an impact on sales?

Ramprakash V. Bubna: Not substantially. We are careful in offering credits and we are careful in offering the products, but there could be some small impact, but not much.

Nihal Jham: Sir, the next question is on the gross margin side obviously you mentioned about increasing technical prices, but is it mainly that or is the mix change also impacted that, I just would want to get a sense of what has been the mix change has impacted our margins in this quarter?

Ramprakash V. Bubna: I would say it is mainly the increase in the cost of raw materials and technicals.

Nihal Jham: Just last question to ask you Sir, I think last quarter, there was a discussion on the depreciation number, which has increased significantly and even in this quarter we see it is Rs.35 Crore kind of a number when compared to last year where our numbers are around Rs.22 to Rs 23 Crores, despite has not seeing a big increase in the registration, so just wanted to understand that what has led to this increase compared to last year and would this be the run rate of depreciation going forward too?

Ramprakash V. Bubna: See, this depreciation is an effect of the capitalization that has happened in the last year and if the gross block has increased, the depreciation will continue to be at this level and this has nothing to do with this quarter as such, it is the total capital expenditure, which has been incurred in the last financial year.

Nihal Jham: There has been no change in policy?

Ramprakash V. Bubna: No, there is no change in the policy.

Moderator: Thank you. The next question is from the line of Varshit Shah from Emkay Global. Please go ahead.

Varshit Shah: Sir, is it possible to quantify geography wise gross margins, since we have mentioned in the presentation that the margins were lower in Europe, so is it some Euro specific RM issues, product specific or is it something else?

Ramprakash V. Bubna: I will tell you, the gross margin in European region overall both agro and non-agro have declined from 42.1% to 36.5%. In NAFTA region it has declined from 19.7% to 19.6%. LATAM, there is slight improvement in gross margins from 25.5% to 29.1% and Rest of the World there is a slight decline from 25.7% to 22.2%. So, if you look at in the totality, European region is very precious region for us. There the gross margins have declined by about 5.5%.

Varshit Shah: Sir, in the European and NAFTA region, the reason for decline is entirely raw material or there is some reverse operating leverage also part of it?

Ramprakash V. Bubna: See, most of it is increase in the price of raw materials, which we are not able to pass onto the customers and there is also slight element of increase in the competition, mainly the price of raw materials.

Varshit Shah: Sir, if were to ask what was the reason for growth in Latin America, I mean margin expansion in Latin America because is there a currency factor or anything else?

Ramprakash V. Bubna: See, in some pockets of Latin America, we have been able to get good business, but the total business share in Latin America is limited as compared to the NAFTA and European Union.

Varshit Shah: No, Sir, of course I understand that what I was trying to allude to is what is the reason for expansion in margins in Latin America?

Ramprakash V. Bubna: Product mix that we have been able to get some good business in the products, which were giving a better margin.

Moderator: Thank you. The next question is from the line of Chetan Thakkar from ASK Investment Managers. Please go ahead.

Chetan Thakkar: Sir, I just wanted the volume data if you can share that for the quarter and also wanted to understand one thing when do we see this pricing pressure moving away from Europe?

Ramprakash V. Bubna: In European Union, there is a decline in the volume from 3.1 million kg to 2.96 million kg, a slight decrease. In NAFTA, there has been an increase from 1.55 million to 1.90 million. LATAM, there is a decline from 8,33,000 kg to 5,59,000 kg. Rest of the world, there is a decline from 6,63,000 to 4,58,000. Overall declined from 6.14 million to 5.9 million.

Chetan Thakkar: Got it Sir. Gross margin issue in Europe that we are facing, is it because there are inventories lying in the channel and everyone wants to get rid of them and the bad season the prices have not gone up or is it now structural change that these will be the gross margins there, unless raw material prices come down?

Ramprakash V. Bubna: See we have a large portfolio, so it depends on molecule to molecule. It is not general, but the tendency is that the multinational companies are not increasing their prices and we are linking our prices only to the multinational companies because both of us do not want to lose the market share.

Chetan Thakkar: Sir, just one last question, we have seen depreciation go up because of capitalization of intangibles, the benefit of this will accrue over the next year or probably by Q4 we should see that in the main season when we will be able to sell these products or it will be spread out more over three-year period?

Ramprakash V. Bubna: It would be spread out.

Chetan Thakkar: And over what timeframe would that be spread out?

Ramprakash V. Bubna: I would say 2 to 3 years.

Chetan Thakkar: So, Q4 is now the quarter when we are really hopeful of things to revive?

Ramprakash V. Bubna: Yes Sir.

Moderator: Thank you. The next question is from the line of Vishnu Kumar from Spark Capital. Please go ahead.

Vishnu Kumar: Sir, in the NAFTA region, you just mentioned there seems to be a lot of growth, is it because there is a mix change, but our growth is not reflecting in the revenue is it because of mix change. Could you just elaborate there?

Ramprakash V. Bubna: Sir we have got some more registrations there. So there is a small change in the mix. We were able to penetrate better into the market to increase the share.

Vishnu Kumar: But our revenue is not showing any traction, as you mentioned there is some issue in US, but we are seeing a considerable volume growth, but our revenue is not showing any growth because volume increase you have mentioned about from 1.55 Mn to 1.9 Mn?

Ramprakash V. Bubna: In NAFTA region, there has been a growth in the revenue also about 18%.

Vishnu Kumar: In Agro segment, there seems to be very nominal growth, it is only 2% growth.

Ramprakash V. Bubna: Yes, 1.2%.

Vishnu Kumar: But volume wise there is a massive growth?

Ramprakash V. Bubna: Yes.

Vishnu Kumar: If I have to connect the dots is it probably the mix changes bring down the revenues, is that the right understanding?

Ramprakash V. Bubna: Yes Sir.

Vishnu Kumar: Sir, secondly incrementally you also see that you are stepping up your efforts in terms of the US market, which is the lowest margin region as of now, so in the next couple of years how should we read the overall gross margin for your company, what would be the rough number that you are targeting?

Ramprakash V. Bubna: I would say it should be about 30% plus or minus 2%.

Vishnu Kumar: 30% plus or minus 2% would be the number. We have done 33% to 35% in the past. Do you think there is a case for these numbers to come or structurally we are now going to be at 30% around?

Ramprakash V. Bubna: We are always hopeful, we hope 35% to 36%, but it will take some time.

Vishnu Kumar: Sir, under what conditions in Europe do you think there will be an improvement in the margins, I understand that you are saying that by fourth quarter we will see some revival in growth, what are the conditions under which your 36.5% margin in Europe probably will go back to the 40% plus or what has to change in the ground for you to get there?

Ramprakash V. Bubna: First of all, we expect the weather to be not as bad as it has been, with the improvement in the weather conditions there will be increase in the demand and that will help us to increase the volume as well as the revenue. The demand traction will happen only with the improvement in the suitable weather conditions.

Vishnu Kumar: In terms of margins what will drive improvement let us say 35% to 36% European margins going to say 40% plus, do you think if the technical prices reduce from the Chinese technicals side or you think that the innovators will start increasing prices next year onwards, which do you think will lead you to get the better margin in the European zone?

Ramprakash V. Bubna: We are also always hopeful of getting new registrations and in the new registrations we have lesser competition over a period of many years for some of the products, which used to give us good revenue have become commodities now. So, we are hopeful of being supported by more and more registrations.

Vishnu Kumar: Sir if you could just give us the capital expenditure number for this year and if at all if there is any number that you have in mind for the next two years?

Ramprakash V. Bubna: We are expecting the capital expenditure to be in the region of Rs.150 to 170 Crores in the financial year 2020.

Vishnu Kumar: In this how much would be US and Europe, broadly if you could give some breakup?

Ramprakash V. Bubna: I do not have that breakup off-hand.

Vishnu Kumar: Next two to three years should we expect this number to continue?

Ramprakash V. Bubna: Yes, please.

Vishnu Kumar: Or is there going to be a slightly growth increase or this number will go up?

Ramprakash V. Bubna: Which number are we talking about?

Vishnu Kumar: The capital expenditure number for FY2021 and FY2022, can it go up to say that Rs 200 crore to Rs 250 crore range or will we continue at this number?

Ramprakash V. Bubna: It may go up to Rs 200 crore, as I explained in the past, the process of registration is very complicated and unpredictable, and this is depending upon lot of factors, which you cannot predict. The process of registration depends upon lot of bureaucratic procedures, the meeting by various committees in every country they take place not always on schedule, delays in the evaluations, delays in the field trials, so it is difficult to predict. This is just our rough estimate.

Vishnu Kumar: For the data compensation in US, is that completed or for one product one registrations we were told that data compensation is still being decided?

Ramprakash V. Bubna: Mr. Vishnu, the data compensation is the continuous process. We keep on getting registration on new molecules and every molecule the data compensation has to be negotiated with the innovator. This process may take two years, or it may take eight years.

Vishnu Kumar: I was referring to one molecule in the US, which you are saying that within the next year or so we will close for one large molecule, we were suppose, to close the data compensation for that?

Ramprakash V. Bubna: No, that process is still going on, not yet completed.

Vishnu Kumar: On the China side I just wanted to understand your views how is the pricing trends now and in the next year or so, do you see any changes happening favourably or unfavourably?

Ramprakash V. Bubna: This again depends upon molecule to molecule and also some factors, which are unexpected and not predictable like there was a very big explosion in some industrial area in China sometimes in the month of March. That had a very negative sentimental impact on all the industries including the government. The government closed some industrial areas left and right and again there was some accident about a week or two back. Secondly, the Chinese government was very strict in implementing the pollution control rules. Now there were some indications of the relaxing on this control in order to support the industry against the impact of China-US trade war. So there are many factors, but I do not see any substantial or any big escalation in the prices of the raw materials as of today.

Vishnu Kumar: Revenue mix if you could just share with us the volume, price and currency impact, Mr. Ashish, I just missed the number, Sir?

Ashish Lodha: Volume was negative 4.2%, product and price mix was negative 3.8% and exchange was favourable 0.7%.

Moderator: Thank you. The next question is from the line of Nitin Agarwal from IDFC Securities. Please go ahead.

Nitin Agarwal: Sir, on the gross margin bit just to understand a little better, you said the gross margin pressure is because of the increased raw material pricing that you are not able to pass on to the customers, this is largely because the demand is softening in the geographies or there is something structurally changing in the market or only a temporary phenomenon because the demand is soft so you cannot pass on the price hike?

Ramprakash V. Bubna: As I explained to you, we cannot individually decide to pass on it. Our pricing policy always had some discount to the innovators prices. So if the innovator does not increase the price, we get stuck. We cannot increase the price over the innovators prices.

Nitin Agarwal: Sir, in your assessment have you seen this happening more often as a trend or this is something that you should be worried about as a structural issue or it is not something, which seems to be permanent?

Ramprakash V. Bubna: I think, I would not use the word permanent, but I am sure the multinational companies will see some advantage in increasing the prices for their own reasons. They are careful not to lose the market share. But they will do some evaluations; their own internal evaluations and I think they will be forced to increase the prices in the course of time.

Nitin Agarwal: Sir, link to that what kind of leeway do we have in such situations to negotiate with the vendors, with the suppliers?

Ramprakash V. Bubna: Suppliers side we are doing the negotiation, which is a continuous process for us. We always try to put the pressure on suppliers to give us as low price as possible.

Nitin Agarwal: How is the dynamic now playing out post disruption in China last year, I think the supplier side issues for you has begun to settle down now, they are back to normalcy?

Ramprakash V. Bubna: They are slowly settling down.

Nitin Agarwal: As a fair assessment as we go through the year we should be in a more normal unless and until something new happens, we should be in a fairly normal situation by the time the next season starts?

Ramprakash V. Bubna: We will be moving towards normalcy. I cannot say that we will reach the normalcy and also find out what is the normalcy. But we are getting indications that the pressure will soften down.

Nitin Agarwal: Sir, in terms of the suppliers from China have you seen a certain amount of discontinuation of supplies like reduction in the number of suppliers in terms of which probably increases their leveraging power or there has been a constant news flew around that the number of companies in China have been shutting down, so is that changing any other supply dynamics over there?

Ramprakash V. Bubna: Yes, you have already answered my question. There is a decrease in the number of factories. The smaller factories are being closed. The factories, which are not able to put up or hold pollution control measures they are getting forced to close. Only bigger factories are going very well in a very normal way or in a better way, so to that extent our options for the buyer is getting reduced to some extent.

Nitin Agarwal: But fundamentally that does not impact our business model right, I mean in terms of the business the way we conduct does it fundamentally impinge that?

Ramprakash V. Bubna: No, it does not impact fundamentally.

Nitin Agarwal: Sir, lastly how are we looking at registration spends over the next two to three years or what quantum we are looking at?

Ramprakash V. Bubna: I have just answered the previous participant that we will continue to spend about Rs 150 crore to Rs 170 Crores every year on capital expenditure, which are mainly the registrations.

Nitin Agarwal: Sir, have you seen any increase in cost towards registrations over the years?

Ramprakash V. Bubna: There is an increase. There is a substantial increase in the cost.

Nitin Agarwal: Is that possible to generalize it in terms of what would be the quantum of increase in registration cost for example in Europe?

Ramprakash V. Bubna: See, it depends upon molecule-to-molecule my dear friend, but the demand from the authorities are increasing. The number of studies and parameters the authorities are asking and number of tests that they are asking that is increasing, so that is increasing the cost also.

Nitin Agarwal: Lastly if you can squeeze in, this increase in cost on specifically European side, in your experience is it reducing the number of players and probably some of the newer registrations that you are seeking or that is not having any impact on the number of players, the kind of competitive situation in these markets for new molecules?

Ramprakash V. Bubna: So, in European Union, there has not been a big rush, the number of players as it is very few and I think they will continue.

Moderator: Thank you. The next question is from the line of Madhav Marda from Fidelity Investments. Please go ahead.

Madhav Marda: Just wanted to understand your outlook for the coming year for North America, Latin America and Europe, just in terms of the season inventory situation because some the companies like BASF have issued profit warnings, so just wanted to get a sense on how you are looking at the market?

Ramprakash V. Bubna: Sir, as far as the revenues are concerned, we look forward to increase in our share of the revenues from North America and from European Union. Latin America, many of these countries are facing lot of economic and administrative problems, the cross-country exchange rates are unstable and the currencies are getting devaluated, that has a negative impact from the purchasing powers and paying powers for the customers and the farmers. So, in my opinion the business in Latin America may stay or may slightly go down unless the economies and the currency rates are getting stabilized.

Madhav Marda: North America market, there has been some issue around the flooding that few of the global companies have been highlighting, if you could just give your comments on that?

Ramprakash V. Bubna: There has been issue of flooding, excessive rains and even disruption of transports and lot of things, also the winter got extended. So, the weather has been very unpleasant in North America. But now I feel that the things are improving, and we hope that it will continue.

Moderator: Thank you. The next question is from the line of Nihal Jham from Edelweiss. Please go ahead.

Nihal Jham: Sir, my first question was on LATAM, if we look at our performance over the last four to five years where Europe and NAFTA have grown, LATAM is obviously a region, which has seen a fall in sales over the last five years and at the same time the Latin American market has improved in both generic as well as innovators have done well in the market, so is it the product specific issue that we are facing or is it that we are focused on geographies, which are not done well in LATAM because generally the major countries in LATAM have performed well, so just wanted your thought on that?

Ramprakash V. Bubna: So, in my opinion many of the Latin American countries are going through lot of economic challenges. Their currencies are depreciating and that brings a lot of disability and instability in the economy, capacity of the farmers and distributors to pay because most of the trades are done in US dollars.

Nihal Jham: Sir, asking that from which countries do we get majority of our sales from in LATAM?

Ramprakash V. Bubna: Some Central American countries, Argentina, Peru, Dominican Republic.

Nihal Jham: Brazil is not very significant for us?

Ramprakash V. Bubna: Yes. Brazil is not very significant for us.

Nihal Jham: Sir, just if you give the registration pipeline region wise and the total count of registrations also?

Ramprakash V. Bubna: Total amount of registrations as on June 30, 2019 was 2,325. European Union 1,156, NAFTA 209, LATAM 728 and Rest of the World 232. Pipeline we have 1,095 registrations out of which 790 are in Europe, 83 in NAFTA, 168 in LATAM and 54 in the Rest of the World.

Moderator: Thank you. The next question is from the line of Prashant Biyani from Prabhudas Lilladher. Please go ahead.

Prashant Biyani: Sir, if you look at the portfolio basis pricing impact of the innovators over the last five to six quarters most of the global innovators have seen increase in price on a portfolio basis and the largest exporter of agrochemical from India has also been seeing realization increase, so in which particular geography are you seeing pressure on realization or competition from innovators on the pricing thing if you can just highlight that?

Ramprakash V. Bubna: The competition from the innovators is more in European Union and NAFTA. And what was your next question, the two questions?

Prashant Biyani: Any particular reason why we are competing on these two geographies only and not in any other geography?

Ramprakash V. Bubna: These are the geographies where the margins are booked, the rules have to be followed and the prices have to be maintained. In other geographies, the registration process is not so complicated, not so expensive. So, the competition is high and even the innovators do not have so much of a concentration. They concentrate mainly in the developed region, which is European Union and NAFTA countries.

Prashant Biyani: Like you said in Europe already, there the number of players operating is less, so ideally the competitions should be less in EU?

Ramprakash V. Bubna: Yes, competition is less.

Prashant Biyani: But even then, pricing pressure is persisting?

Ramprakash V. Bubna: Because the innovators are not increasing the prices and the cost of production is going up.

Prashant Biyani: Sir, I am not getting clarity because again as you were mentioning on a portfolio basis even the innovators are seeing price increase over the last four to five quarters, but we are struggling on that part?

Ramprakash V. Bubna: See, what I am saying that the products that we are selling in this region, the innovators are keeping price constant they are not increasing. I do not know from where you got this information that they are increasing the prices if they are then I am not aware of that.

Prashant Biyani: Sir, secondly on this belts division, any outlook regarding growth, what correctly we have been doing over the last five to six quarters that we have seen such a sharp growth, and would the growth rate be the same going forward?

Ramprakash V. Bubna: Yes, we look forward to the same rate in the growth of belts business.

Moderator: Thank you. The next question is from the line of Jasdeep Walia from Infina Finance. Please go ahead.

Jasdeep Walia: Sir, how do you explain the decline in gross margins from fourth quarter FY2019 to first quarter FY2020 because I guess pricing would have remained flat and your commentary in fourth quarter suggested that RM prices also will remain flattish going forward, so is it that you have taken a price correction that gross margins have corrected from fourth quarter FY2019 levels?

Ramprakash V. Bubna: See, one of the factors has also been the cross-currency exchange rates. In European Union we are selling most of the businesses in Euros. There has been a decline in the Euro dollar exchange rates, which has impacted us very directly. Secondly, there has been some closure of some factories in China with the result the demand has been more for the products and that had put some upper pressure on the prices of raw materials.

Jasdeep Walia: Our RM prices have increased from fourth quarter FY2019 levels?

Ramprakash V. Bubna: Yes.

Jasdeep Walia: And you have not taken any price correction, you have not reduced prices from fourth quarter 2019 to first quarter FY2020?

Ramprakash V. Bubna: See, in general we have not, but in some products, we may have to do it because the competitors are not increasing the prices.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to the management for closing comments.

Ramprakash V. Bubna: On behalf of Sharda Cropchem Limited, we thank you all the participants and looking forward connecting for next quarter. Thank you.

Moderator: Thank you very much Sir. Ladies and gentlemen, on behalf of Emkay Global Financial Services, that concludes this conference. Thank you for joining us. You may now disconnect your lines.