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Q3FY16 Conference Call Transcript

Moderator:

Ladies and Gentlemen, Good Day and Welcome to the Coromandel International Limited Q3 FY'16 Earnings Conference Call hosted by Emkay Global Financial Services. We have with us today Mr. Sameer Goel – M.D., Mr. S. Sankara Subramanian – CFO, Coromandel International Limited. As a reminder, all participants' line will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of this presentation. If you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Rohan Gupta -- Research Analyst with Emkay Global. Thank you and over to you Mr. Gupta.

Rohan Gupta:

Thank you, Aman. Good Afternoon, Ladies and Gentlemen. On behalf of Emkay Global I thank all the participants logged in for the conference call of Coromandel. From the management, we have Mr. Sankarasubramanian and Mr. Goel. Sir, Good Afternoon to both of you. Sir, first of all I will request you if you can take us through the Current Quarterly Results Performance and also the Industry Trend and then we can follow it up with Q&A Session.

Sameer Goel:

Good Afternoon, Everyone. What I will do is, I will take you through the Business Environment and Shankar will then take you through the Industry and the Company's Performance. So thanks Rohan for organizing this con call.

Let me first begin with giving you an overview of the business environment experienced during the 3rd Quarter. Firstly, as you know this has been unprecedented second consequent year of drought in the country in the last 50-years. So as a result sowing acreage of most of the crops have been low against 596 lakhs hectare sowing which happened by mid-January last year, we are currently at 577 lakhs hectares as per the latest data available from Ministry of Agriculture. India's wheat output is expected to fall for the second straight year in 2016 due to unusual warm winter in central and northern India. So if you see except Course Cereals, other crop acreages have come down; Wheat has come down by 5%, Rice by 6%, Pulses by 3% and Oil Seeds by 4%. It is Coarse Cereals which has actually grown by 7% as farmers are turning to hardier crops. All India rainfall during the post monsoon period October-to-December was also down by 23% over normal levels. However, the southernmost part of the peninsular India received good rainfall; in fact, it was almost a deluge in some parts. So even Northeast monsoon status over peninsular India out of the seven zones we have- Coastal AP is down by 16%, Telangana is down by 78%, North Interior Karnataka down by 52%; however, monsoons have been good in Tamil Nadu at 53%, Kerala 27%, South interior Karnataka 17% and Rayalaseema a few districts at 77%. So the lower rainfall impacted the reservoir levels with the current storage being 49% against last year 62%. Southern India faced the biggest drop, where the current storage is 34% compared to the previous year's 51%. However, for the next year, we are expecting normal to excess rainfall conditions. Global forecasters have projected monsoon favoring La Nina conditions in 2016. And even forecasters from US, Japan, Europe and Australian agencies have projected weakening of El Nino conditions and transition to neutral or La Nina conditions. On the price support front, the government announced better minimum support prices for the Rabi crops- greater focus has been given to Pulses wherein Rs.75/quintal bonus is given over and above the 8% MSP rise. Wheat price has gone up by 5.2%, barley 6.5%, Gram and Masoor 7.9% and 8.1% respectively, Mustard at 8.1% and Sunflower 8.2%. Now Shankar will give the Industrial Fertilizer Sales Volume.

Moderator:

Mr. Rohan Gupta
Research Analyst,
Emkay Global Financial Services Limited

Management:

Mr. Sameer Goel
Managing Director
Coromandel International Limited

Mr. S. Sankarasubramanian
Chief Financial Officer
Coromandel International Limited

Mr. G. Veerabhadram
Business Head, Agrochemicals Business
Coromandel International Limited

S. Sankarasubramanian:

Overall, if you look at Phosphatic volumes dropped by 3% in Q3 because of the reasons alluded by Mr. Sameer. However, in this quarter, DAP volumes have gone up by 3% and Complex segment degrew by 9%. Basically, the consumption during this quarter is more driven by North India where the DAP consumption is generally higher than Complex. If you look at our primary markets where we operate Andhra Pradesh, Telangana and Karnataka, industry has seen a significant drop in volumes, Andhra volumes are down by 22% at the industry level and Karnataka volumes are down by 21% and Telangana is 12% down. In the North, the pipeline inventory has significantly gone up because, as you all know, the first half witnessed significant increase in DAP imports and the same has been positioned in the market and that has actually increased the channel inventory in the system. So we do expect sort of channel inventory to take some time for liquidation to happen until the Kharif season starts next year. On the Potash side, the volumes are very subdued in Q3 basically due to lower consumption in Southern markets. The Urea sales during the quarter went up by 9%. So overall it is sort of weak industry performance in the south and not so great performance in the north because monsoon conditions were not favorable especially in states like UP.

But overall on the reform side, government has announced a New Crop Insurance Scheme and that is going to really help the farmers to cover their risk. Specific to our company's business segment organic manure the government has announced subsidy of Rs.1500/tonne; we are yet to get the complete details but this will definitely help in expanding the volumes in this business. Coromandel has been a pioneer in this business for the last 4-5-years and it is a very positive step for the country as a whole and especially for Coromandel as well.

On the Raw Material side, the industry witnessed softness in prices, in fact, DAP price during this quarter went down significantly from $440-$450 to close to $400. Continuous fall in crude prices had an impact on both Urea and Ammonia prices; urea price is now close to $200, it is a historical low;Ammonia prices are sub-$400. All this softness in raw material price changes are definitely good for the industry and it will also reduce the pressure on working capital. Continuous reduction in LNG prices and crude prices helps across the business segments where Coromandel is operating, whether it is a gas price consumption for Agrochemicals business. Also, it helps in keeping the Urea and Ammonia prices lower, which are the key input raw materials for Fertilizer business. So I would say that from the softening price trend, it is favorable for the industry as a whole and also for us.

Coming to Coromandel's performance for this quarter, our overall production volumes are down by 10%, production for DAP and Complex for this quarter is 6 lakhs tonnes as against 6.7 lakhs tonnes what we recorded during last year in Q3. Our sale of manufactured products was 5.2 lakhs tonnes versus 5.8 lakhs tonnes. Our production was moderated in tune with sales especially in the southern markets. Since the monsoon were not good, so we did moderate our sales as we have consciously taken a decision not to place too much of inventory in the market and that was one of the main reasons why there has been a decline in manufactured product volume. Also our imported DAP numbers are more of liquidation of opening stock what we carried on from Q2 - so volumes are more of flattish compared to last year's 0.7, this quarter we recorded 0.6 lakhs tonnes. So overall if you take Phosphatic volumes, we are down by 11% in Q3 at 5.8 lakhs tonnes versus 6.5 lakhs tonnes, major drop happening in the manufactured product. While the volumes are down but we have improved our market share in our core markets of Andhra- in fact, our Andhra, Telangana markets have moved up from 61% to 68%. But at All India level, market share is down from 15.5% to 13.9%. Actually we should see this in the context of overall Q3- generally our core markets do not have active season and this is the season for northern and central Indian markets, where we do not have a major presence in DAP and other segments. So that way, our market share overall for this Q3 is marginally lower than last year.

Coming to Non-Fertilizer Business: Domestic Agro-Chemicals and Specialty Nutrients performance was moderate; it has improved compared to our Q2, but industry still faces pressure due to poor water levels in all the major reservoirs especially in AP and Karnataka. The Rabi season is actually a clear wash out because of lower reservoir levels and also the poor liquidation resulted in lower money flow and market returns. At this point of time our industry estimate is 20-25% of market return has happened and there has also been price erosion in some of the key molecules. So in that situation, I think our Agrochemicals business has performed reasonably well and one of the positive aspects is while Domestic Agrochemicals had a decline, our erstwhile Sabero unit has reported a stellar performance and made up for the drop in Domestic Formulations business. One of our key flagship molecules Mancozeb actually has done very well both in terms of volume and price realization and erstwhile Sabero unit has improved significantly in terms of profitability over the corresponding period last year.

Coming to Specialty Nutrients Business: The volumes are moderate because it more or less tracks the Fertilizer business and the monsoon pressures did impact it. But in spite of that in some of the key markets we have grown.

On the SSP business, we have improved our market share. We sustained our leadership position in terms of volume; we have done 1.45 lakhs tonnes and our thrust and quality is there and our branding initiatives have been well received by the farming community, and in the major operating states in West and North we have performed well. Margins continue to be area of concern and I think that will go away once farmer starts feeling the quality of the product and as and when monsoon situation improves we should be able to improve on our performance on SSP.

Retail business in spite of adverse market situation, low monsoon conditions in Telangana has reported very good performance in Non-Fertilizer segments while Fertilizer volumes are down. Non-Fertilizer segment has done well and this has helped in improving the overall performance of Retail during this quarter. And also at company level we have introduced new grades during this quarter and our thrust and focus on unique grades will be there and that will improve our performance going forward in the future quarters.

Coming to the Financial Performance: Our consolidated turnover is around Rs.2,755 crores- actually there is a drop in top line of 7% in comparison with last year Rs.2,962 crores basically due to drop in volume of Fertilizers. Our share of subsidy business is around 82% and balance 18% of the top line is coming from non-subsidy business.

Our cumulative 9-months top line has grown by 2% from Rs.8,309 crores to Rs.8,500 crores. On the EBITDA side, our quarterly EBITDA is at Rs.165 crores against Rs.225 crores of last year and this is due to the margin pressure on Fertilizer during this quarter. Our share of Fertilizer EBITDA is 55% and share of non-subsidy EBITDA is around 45%. There has been significant increase in non-subsidy share of EBITDA. Fertilizer EBITDA is mainly under pressure due to lower production- there has been an under absorption in our fixed overheads and also whatever we manufactured this quarter we have slightly increased our share of manufactured DAP. For manufactured DAP, as we mentioned in the past, the margins are not very high and that has also impacted our EBITDA for this quarter. Besides that, we have done traded volumes of imported DAP as well as Urea and Potash where the margins are not significant. So there has been a slight shift in the turnover mix and that has actually brought down the EBITDA percentage. But in the case of Non-Fertilizer, the formulation EBITDA drop has been made up by improved performance from our technical business of Sabero.

So overall our consolidated net profit after tax during this quarter was Rs.80 crores as against Rs.121 crores. During this quarter, we have also recognized the income of Rs.25 crores what we have received from insurance company towards our loss of profit claim for our Vizag unit. So cumulatively our net profit for 9-month is Rs.268 crores against Rs.333 crores of last year.

Our long-term debt-equity continues to be marginal at 0.06 as against 0.17 last year. Net debt-equity is at 0.77 as against 0.95 of last year. Our subsidy outstanding is around Rs.1,582 crores and it was Rs.1,400 crores in Q2; we have received subsidy up to September, we are looking forward for the balance period.

With this, I complete my update and we can now go for Q&A Session.

Mr. Veerabadram -- our Business Head for Agrochemicals business has also joined the call. So he can also share some points or views or queries if you have on Agrochemicals business. Thank you.

Moderator:

Thank you very much. We will now begin the Question-and-Answer Session. The first question is from the line of Sudarshan Padmanaban from Sundaram Mutual Fund. Please go ahead.

Question and Answer Session

S Padmanaban:

Sir, my question is on the volume side. If I am looking at the manufactured volume vis-à-vis the industry, we have been slightly lower in terms of what our peers have done. More so if I am comparing the numbers in terms of manufactured EBITDA and the overall EBITDA coming in from the Fertilizer business, there seems to a fair amount of drop in the EBITDA per tonne kind of a number. The first thing is, you did was not to fill the inventory and push excess inventory into the system, but also we had some issues in terms of sourcing materials. The lower manufacturing… is it on account of that as well or is it primarily on account of your strategy of not pushing too much of inventory into the channel?

S. Sankarasubramanian:

Actually this quarter, our call to restrict production is to align with the sales even though acid availability has significantly improved. Also, we decided to restrict the acid during this quarter anticipating a price fall in the next quarter. So it is not an acid constraint which led to production, it is more of system inventory and our conscious decision to restrict the inventory level. Coming to the margin structure, as I mentioned, lower production generally leads to under-absorption of fixed cost. That is one factor. Also this quarter we produced more share of DAP because basically this season the sales happens more in the northern markets where the DAP is also a preference, so we sold higher volume of DAP where the margins are lower. In terms of a Complex Fertilizer margin, there is no let up on that margin structure per se. All these factors led to the percentage of margin drop.

S Padmanaban:

Going forward, we have also seen drop happening in the input prices, if I am looking at probably two-three quarters down the line, as and when we move to the next Kharif, do you think that benefit would accrue to you in terms of your margins per se? Can you also give us some light with respect to your competitive landscape on Fertilizer in South because what we are hearing from the channel is that southern markets are becoming more and more competitive with northern players coming in, trying to be a bit more aggressive over there?

S. Sankarasubramanian:

Competition is always there in any industry and business. I would not subscribe to this view where it is only South is getting intensified where we have also improved our performance. We continue to focus on our brand and improving our product range and quality and that is really reflecting in our market share; in spite of industry volumes coming down, still we improved our market share from 61% to 68% in Andhra. So I would say that we continue to focus on providing quality product for the farmers and with our presence in Retail, this can only grow stronger.

S Padmanaban:

Going forward for the coming season, do you think that inventory would be a challenge for you to start pushing sales assuming there could be a normal monsoon coming here?

S. Sankarasubramanian:

No, in our addressable markets we are selling what is required and will continue to do so. Early Kharif starts from Maharashtra onwards from May and Karnataka in June and after that in Andhra. So if good season happens next year, definitely this inventory will get moderated. As a Company, we are not unduly worried about the channel inventory at this point of time.

Moderator:

Thank you. The next question is from the line of Viraj Kacharia from Securities Investment Management. Please go ahead.

Viraj Kacharia:

Just had this follow up question on the inventory side. If we see the cycle of 2012-2014, the industry was broadly reeling under excess inventory in the system, but most players reporting flat or negative growth. So, given we also have a similar excess inventory in the system, even if the monsoon were to be normal, it might probably take two to three seasons for the inventory to normalize and therefore, possibility of a subdued volume growth. So for us how is the inventory with respect to the industry in our core market and how do we aim to buck this trend?

S. Sankarasubramanian:

There is a slight difference between what happened last time in 12-13 and what is happening now. Nobody has expected this sort of unprecedented washout in Rabi season and the fall in reservoir level. So people anticipated normal season and stacked up inventory that has resulted in excess inventory. In 12-13, people were carrying inventory for more than a year, but here it is inventory built-up which has happened during the season and also industry has moderated further fresh imports. Even though the DAP price has dropped there has not been significant imports in the last 3-months. In fact, after November we have not seen any major imports happening into the country. Now, more serious players are into the business now, unlike various other players participating due to the opportunity in 11-12, 12-13 which has resulted in uncontrollable levels of inventory. So we think the situation is totally different at this point of time and there has been a reasonable price stability and also there is a softening in material prices. It may not be repeat, may not take longer time to unwind these inventory levels and self-correction mechanism will happen and individual companies will be more prudent and sensible in terms of their fresh procurements and going forward into next season. With the prediction of normal monsoon I think it will get corrected in Kharif itself.

Viraj Kacharia:

So even if the normal monsoon were to occur and the inventory itself were to correct, for us how are we placed in terms of the inventory both with us and our inventory in the channel?

S. Sankarasubramanian:

I may not be able to comment on the channel per se, but in Coromandel we are very focused in terms of selling - what grades the farmer wants and what volumes we want to sell. So to that extent, there are no push sales and to that extent we are in a comfortable situation at this point of time and we do not foresee any problem in utilizing the market opportunity as and when it comes.

Viraj Kacharia:

So what I really meant is in Q2 we had the excess DAP inventory which we were hopeful of good Rabi and therefore liquidating the same. So is that excess DAP inventory which we had with ourselves more or less liquidated and that is what Q3 numbers broadly reflect?

S. Sankarasubramanian:

Our inventory is not even 100,000 tonnes, that is too small by the standard, and the major portion of it got liquidated during this quarter and rest will get over by 4^{th} quarter. We did not do any fresh imports during this quarter. We do not carry much of inventory of imported DAP at this point of time.

Viraj Kacharia:

On the pricing front, as the previous participant highlighted that, we have seen a good moderation in the global raw material prices. There have been talks of government planning to reduce the per ton nutrients subsidy for FY17. So does that by and large offset the potential savings which we may have from lower raw material or even we would be compelled to pass on some to the end market, given our past experience across the cycle, how do we look at this?

S. Sankarasubramanian:

We have to wait and see what would be government decision. It is very premature to make a comment on what government will do on subsidy. But one thing we should understand, while international prices are coming down rupee has depreciated sharply; so rupee has moved up by five big figures during this year from 63 levels to 68 level. So to that extent it has offset some of the input price fall. Even though the MRPs are high some of the industry players are operating at lower price levels because of the excess inventory in the system. So the prices currently what is prevailing in the market will continue and we may have to wait and see what government will do on the subsidy front. Until such time, it is not a correct call to decide whether price will go down or subsidy will go down, we have to wait and see in combination with exchange rate movement.

Viraj Kacharia:

Yes, I meant it more from a margin perspective.

S. Sankarasubramanian:

Way we operate is that we ensure that our inventory is managed better so that we do not end up in huge inventory losses because of stock write-downs and fall in prices. That is one thing as a management we can focus and work on it. Second thing is we ensure that our margins are maintained which means if the price fall has to be passed on to the market place, that will be done.

Viraj Kacharia:

You mentioned about consciously not pushing sales into your system and not participating of what other players were pushing for volume growth. So, is that the reason why you have seen a significant fall in your other expenses partly because we have not participated in discounting game and also partly because we are getting benefits from Sabero in terms of utility cost?

S. Sankarasubramanian:

Partly it is utilities cost improvement as well as control of overheads. We are very conscious of the fact that when we operate the plant at low capacities, we need to be very prudent on fixed cost. So that is one of the key strategies we adopted during this quarter and that is getting reflected in our other expenditure as well.

Viraj Kacharia:

Distribution expenses if we see overall volume growth excluding Urea has been flattish for the first nine-months and if we include Urea it is up by 3%. But if we see our distribution expenses it has increased by 15%. So is it primarily because we are going to new secondary or even tertiary markets where might possibly see under recovery of freight subsidy and therefore we have seen such an increase?

S. Sankarasubramanian:

Yes, partly true, we do move to the longer distance. There might not be any under recovery because at this point of time the long distances are moved by rail, for which the government reimburses 100%. So, at this point of time there are no under recoveries on primary movement.

Viraj Kacharia:

But then what would explain this 15% increase in the distribution expenses on a nine month basis?

S. Sankarasubramanian:

While the sales may be flattish, dispatches would be more because we are carrying field stocks in our company godowns. Dispatch includes the amount spent for the stocks in the godowns in various places and that will get into inventory valuation and is reflected under the change in inventory. Even though there is an increase in distribution cost, but that flows back in the form of inventory valuation.

Moderator:

Thank you. The next question is from the line of Narayan Ravindranathan from E&R Advisors. Please go ahead.

N Ravindranathan:

Sir, in the previous quarter you had mentioned in the export market some of the molecules coming off sharply in Brazil, though Mancozeb has done well for us. So, on the part of the business the molecules which have come off in terms of revenues and all that, did that trend continue this quarter as well at the market level? Just a ballpark understanding of what could be the quantum of decline on this?

G VEERABHADRAM:

This is Veerabadhram. Brazil experienced similar conditions like India in terms of drought, etc., What happens, the molecules which we have been selling in large quantities, industry has got large quantities, remain in stock there. So it is taking time, therefore there is a temporary drop in this year. There is increase in other products like Mancozeb, etc., in Brazil market and that has more than covered up for the loss of volume.

N Ravindranathan:

No, that I understood, but my question is on the molecules which did have a decline. What could be the quantum of decline – was it like 20%, 50%?

G VEERABHADRAM:

A large decline.

S. Sankarasubramanian:

Decline of 20% will be there in the top line, when you are talking about this quarter, but there is no decline in the bottom line. So it is the traded volume which has significantly come off. You can say it is almost not there in the current year especially one of the molecules Chlorpyrifos we did not sell anything this quarter. So to that extent there has been a significant drop in the top line but does not impact the bottom line because we have made it more than that in the Mancozeb and other products.

Moderator:

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

Chetan Thakkar:

Just wanted to confirm the volumes. Our own manufactured is 5,20,000 for the quarter, Traded DAP is 60,000 and SSP would be how much?

S. Sankarasubramanian:

Yes, SSP around 1.45 lakhs.

Chetan Thakkar:

This includes Liberty?

S. Sankarasubramanian:

This is mainly Liberty.

Chetan Thakkar:

Any trading on Urea front?

S. Sankarasubramanian:

Urea during this quarter was 3.2 Lakh.

Moderator:

Thank you. The next question is from the line of Amar Mourya from India Nivesh. Please go ahead.

Amar Mourya:

Sir, when we talk about the non-subsidy business and when we say that margins had improved during this quarter, so what were the key reasons behind margin improvement just wanted to understand if you can elaborate further on that?

S. Sankarasubramanian:

I mentioned the share of EBITDA has gone up, it is not the margin per se on a standalone basis; in the overall pie the share of Non-Fertilizer business has moved up to 45% during this quarter.

Amar Mourya:

So it is because of the Fertilizer business not doing well in this quarter, right?

S. Sankarasubramanian:

Yes, to that extent partly attributable because the overall pie has come down and Fertilizer performance profitability was not up to the mark, so the non fertiliser share has gone up. Also within that non-fertilizer segment, the Agrochemicals business which is part of the erstwhile Sabero that has improved its profitability basically due to 2-3 reasons -- one is the sale of Mancozeb molecule went up, the realization of Mancozeb has also gone up and rupee depreciation has been improving the earnings for the exports during this quarter which has been very comfortable. Also, the utilities cost came down significantly because of gas prices coming down. So this has resulted in the significant margin expansion of Sabero unit which used to be 8% to 10% or 11% that has almost gone up by 50-60% increase in the EBITDA percentage. So that has really helped in improving the profitability of the Agrochemicals space. In all other businesses, the margin percentages are more or less in line with last year and Retail business could improve the share of non-fertilizer that improved the profitability.

Amar Mourya:

So sir, out of this 50-60% improvement in the EBITDA, what is the currency tailwinds which we got… what would be the percentage of that?

S. Sankarasubramanian:

If 12% has moved to 18%, 1.5-2% would be attributable to currency.

Amar Mourya:

Otherwise, rest is all due to the utility charges coming down…?

S. Sankarasubramanian:

Also the volume of high margin products having gone up during this quarter.

Amar Mourya:

So the volume of Mancozeb and realization of Mancozeb looks sustainable?

S. Sankarasubramanian:

Yes, there seems to be a gap in demand, going forward also and the team is working on how to expand the capacity there to take advantage of this market situation.

G VEERABHADRAM:

Currently, there is a difference between demand and supply. So we are taking advantage of that.

Moderator:

Thank you. The next question is from the line of Janakiraman Rengaraju from Franklin Templeton. Please go ahead.

J Rengaraju:

Good Afernoon Mr Goel. It has been about 3-4-months since you took charge and so by now I am sure you would have become familiar with the business. So what is your reading of the business -- what are the aspects of the business that you think need improvement and what are the kind of strategic goals that you have set for yourself?

Sameer Goel:

The industry is in a way not new to me partially because we belong to the farming community, so we have been at the receiving end of the industry as such and obviously we have grown with the industry. So that is one thing. Having said that, Coromandel has a very strong brand name in its market which is something quite unique and the employees are very motivated in terms of commitment to the Company. So that becomes the other thing. Third which I was very happy to see is the diversified portfolio which we have and you can see that reflected even in the quarter. So we are not just a Fertilizer company but we are into other Agri business per se. So I think in terms of overall strategy, it will continue to be the same as to keep strengthening our other businesses led by crop protection and then is to ensure that we continue to gain our market share in Fertilizer. One of the things which we are doing is to continue to launch and have unique grades and continue to increase the market share which also makes us less of a commodity business and more unique in the industry as such.

J Rengaraju:

A couple of questions on the financial side for Shankar. You have mentioned that due to inventory some of the other players have stacked up to liquidate their stock at slightly lower prices. Does this in a way force a risk to your price realizations?

S. Sankarasubramanian:

In a generic grade like DAP it does impact because imported DAP is common for everyone but it does not impact the Complex Grades.

J Rengaraju:

On the subsidy management part, has there been any progress on the 10% or the retention subsidy which has been pending for a long while?

S. Sankarasubramanian:

Actually government started processing and we have got first bill settled… of course, it is not very significant amount; it is Rs.30 crores but still nevertheless as a process it has started and there are some more in pipeline for settlement. It is a positive thing that they have started looking into this and started disbursing money.

J Rengaraju:

While you mention that RM prices have indeed fallen and on the other side currency has depreciated. Still on a rupee basis the RM prices seem to have fallen a bit. Has it fallen by a magnitude adequate enough to trigger any price change or are you going to hold on to your prices for now?

S. Sankarasubramanian:

If you look at the import price prevailing today, if we have to do the math, yes, it has fallen significantly, but the channel is carrying inventory and definitely it cannot be completely a replacement cost basis since industry is carrying the old stocks in the system. So on averaging out principle of last 3 or 4-months imports, the price what is prevailing and subsidy what is being extended it is fine. But once channel inventory gets liquidated and the fresh material comes in, there may be a correction required either in subsidy or in market price which we have to wait and see.

J Rengaraju:

Roughly on a ballpark basis, what will be your estimate of the industry channel inventory now?

S. Sankarasubramanian:

It is close to 4.5 to 5 million tonnes of additional inventory.

J Rengaraju:

So that is against what national annual demand of some 15-16 million tonnes?

S. Sankarasubramanian:

That is right.

J Rengaraju:

Just refresh my memory; during the peak inventory crisis about two years back, what was the peak level that the channel inventory hit?

S. Sankarasubramanian:

Went up to 7.5 million at some point of time.

J Rengaraju:

As against 7.5 million we are at about 4.5-5 million now?

S. Sankarasubramanian:

That is right and it has to only taper off from now on because industry is not taking any material further. The current import price is also not a true reflection because when India stops buying the price falls but once India gets in the market the price will go up. We need to wait and see.

J Rengaraju:

But whoever is having this channel inventory as of now especially in an environment of deflating input prices, they are carrying significant price risk, is it not?

S. Sankarasubramanian:

Yes, some players have started averaging out and passing on to the market and we will be forced to pass on to the market. While the MRP is at particular level, people are already operating 10% lower than the MRP. This happened generally in the case of DAP, which forms the major share of channel inventory.

Moderator:

Thank you. The next question is from the line of Bhavin Chedda from Enam Holdings. Please go ahead.

Bhavin Chedda:

How much would be the DAP inventory in this 4.5-5 million?

S. Sankarasubramanian:

Roughly you can say 60:40; it is all guesstimate Bhavin, I do not have a market wise, plant wise inventory.

Bhavin Chedda:

5.5 million inventory you meant DAP and NPK, right? This is not a Urea figure which is there?

S. Sankarasubramanian:

No, this exclude Urea and Potash, this is merely Phosphatic I am talking about.

Bhavin Chedda:

In this quarter you have increased the DAP production and the volume mix was slightly different. So this is just added to the market demand or which led to your mix going for a change?

S. Sankarasubramanian:

Two things -- one is we want to meet the market demand because the manufactured DAP in a tough market situation definitely attracts brand premium compared to imported DAP. So we wanted to produce and supply DAP. Second thing, it is also a better way for us to liquidate high cost Phosphoric Acid, which we could do successfully.

Bhavin Chedda:

What was the Phosphoric Acid contract in the quarter and what is expected for the next quarter contract?

S. Sankarasubramanian:

We have already finalized the price for the fourth quarter which is January to March at $715. It has fallen from $810, about $95 drop.

Bhavin Chedda:

$810 was for September to December quarter?

S. Sankarasubramanian:

Yes, October and December.

Bhavin Chedda:

What was the subsidy booked for the quarter and nine-months in the income statement?

S. Sankarasubramanian:

For the quarter Rs.738 crores.

Bhavin Chedda:

My last question was on own sourcing of Phos Acid. What that number would be and what is the update on TIFERT, how much you are receiving from that end?

S. Sankarasubramanian:

TIFERT situation has significantly improved, in fact, capacity utilization of TIFERT plant has moved up to 40% to 45% now compared to 30% two to three months before. Things are looking better and production has gone up significantly in the last 15-days.

Sameer Goel:

We also have teams working there and they are quite happy and we are doing project management there to ensure that we have regular meeting just to increase the availability from TIFERT, which seems to be working. In fact, they want some of our engineers to continue to be there to help them up.

S. Sankarasubramanian:

TIFERT situation is going to be better going forward and in Foskor, the operational issues are getting fixed. Probably it may take a while for us to get some additional acid from Foskor but overall in this fourth quarter, our Acid situation has improved because of market situation. There are not many takers for Acid, so to that extent there is no constraint at this point of time in terms of Acid availability. We have fair visibility going forward in terms of availability of Acid for next year. With our active participation with TIFERT management as well as in Foskor, I think our Acid situation will improve over the next two to three quarters.

Bhavin Chedda:

So Acid should not be a constraint if at all the demand situation has to improve?

S. Sankarasubramanian:

For our mix and the grade what we are looking at, at this point of time we do not see, but we cannot predict what is going to happen tomorrow. So, at this point of time we have a fair visibility on Acid availability for the next year.

Sameer Goel:

One thing which could help also is China may come into the Acid market.

S. Sankarasubramanian:

That is a positive development.

Bhavin Chedda:

What kind of capacity utilization we should build on the plant roughly going 12-months from now?

S. Sankarasubramanian:

Your guess is as good as our guess. We do not give any guidance. Our plants are tune to operate at full capacity also. So we should wait for the season to come and we will play it out accordingly. Ideally we will be aspiring to reach 90% capacity utilization at the earliest opportunity as and when the demand revives.

Moderator:

Thank you. The next question is from the line of Vinit Sambre from DSP Blackrock. Please go ahead.

Vinit Sambre:

This is regarding the Phos Acid inventory which you just mentioned that you sold more of DAP so that it is a better way to liquidate the high cost Phos Acid. So, as we stand today, are you in a comfortable position as regard the Phos Acid inventory or you feel that because the prices decline there can be inventory related adjustments which can take place in the next quarter?

S. Sankarasubramanian:

We are quite comfortable.

Vinit Sambre:

So there would not be any inventory related losses to be booked in the next quarter?

S. Sankarasubramanian:

May not be.

Moderator:

Thank you. The next question is from the line of Apoorva Bahadur from ICICI Securities. Please go ahead.

Prakash Goel:

This is Prakash Goel here from ICICI Securities. I have a couple of questions; If you factor in the improved performance of Sabero, the other segment performance within the non-subsidized business has come down much bigger. Can you highlight which of the segment is not doing well and as to what is the reason behind the same?

S. Sankarasubramanian:

One thing is the Formulations segment as I mentioned earlier. Domestic Formulations got impacted by bad monsoon and there has been stock returns and fall in molecule prices. So while we would have grown in technical business, it has been offset by the muted performance from Formulations business. All other segments, Specialty Nutrients and Retail have performed on the same level or better level. So there has been no fall in other business segments. Organic volume has also been moderate and the drop has been slightly in the case of Gypsum where our Ennore plant was shut down because of floods in Chennai, so that has impacted our Gypsum income during this quarter as well. So other than that there is no weakness in the segments except for the Formulations business.

Prakash Goel:

The other which I want to reconfirm is that the SSP volume for the quarter.

S. Sankarasubramanian:

Sales for the quarter is 1.45 lakhs tonnes, the cumulative is 4.7 lakhs tonnes.

Prakash Goel:

With respect to the margin, once your volumes grow back to the normalcy, would you like to reaffirm Rs.2000 EBITDA per ton margin is sustainable?

S. Sankarasubramanian:

Yes. I would request you not to look at Rs.2000 every quarter. On an annualized basis and a trailing basis even if you look at four quarters we are still closer to that. So that way we are working towards the EBITDA margin of Rs.2000.

Moderator:

Thank you. The next question is from the line of Prashant Tarwadi from Axis Capital. Please go ahead.

Prashant Tarwadi:

Sir, basically, coming back to inventory issue. Currently, we have I guess 4.5-5 million tonnes of inventory and I guess normalized level inventory should be about 1.5 million tonnes. So, what you are talking about is the rainfall is good, in that case we may see 3-4- million tonnes reduction in inventory in the Kharif season itself? This is against the total consumption of let us say 16-18 million tonnes. So, does this imply that there would be significant reduction in operating rates for the Complex Fertilizer across the industry. So, is my reading right or am I missing something?

S. Sankarasubramanian:

We have to see which markets are carrying this inventory - predominant chunk of the channel inventory is more in the North. So it varies from market to market. If you see this quarter, the south markets have been impacted severely by drought situation and low reservoir levels. There are inventories in the system, but not to the extent what is there across the country. So we have to look at our operating capacity from the point of view of markets where we are operating and how it is going to play out in the next season. Also going forward there has to be a minimum level of inventory which channel would be carrying at any point of time. Gone are those days where the inventory is purchased and paid by the dealer. Because of the increase in value of the fertilizers now the inventory is carried by the companies. So we also need to understand and appreciate the change in the business dynamics post NBS policy - the channel inventories are going to be high, whether what is the ideal level, only the time will say. So at this point of time I would say 2.5-3 million is on the higher side. Whether that will get liquidated is what we should look at. That may not bring about any significant reduction in operating rates for the company which are predominantly operating in Complex segments like us.

Prashant Tarwadi:

Out of this 4.5-5 million tonnes inventory, how much would the government agency would have bought?

S. Sankarasubramanian:

It is very difficult, we are yet to figure out that number, but federations are just buying now, not much of inventory to my knowledge.

Prashant Tarwadi:

A little bit of a clarification; the SSP volume 1.45 Lakh tons you mentioned

S. Sankarasubramanian:

That is for the quarter

Prashant Tarwadi:

Yes, but the own production volume sold is 5.2, so this 1.5 is included in the 5.2?

S. Sankarasubramanian:

No.

Moderator:

Thank you. The next question is from the line of Rakesh Vyas from HDFC Mutual Fund. Please go ahead.

Rakesh Vyas:

Just a clarification; you said the margin in Sabero has improved from 8-9% by around 40-50%. Is that correct or from 12-13% and then 40-50% higher than that?

S. Sankarasubramanian:

Year before when the operating capacity was low, it was at some point of time 8-9%; then it moved to 12% and now it has expanded to 16%-17%.

Rakesh Vyas:

What is the utilization now?

S. Sankarasubramanian:

Still operating the plants at 60% to 65%. But the molecules which matter to us, we are operating at full 100%. But for certain molecules like Monocrotophos, we decided to moderate the production due to the domestic market situation. That is why the average overall capacity utilization still remains to be at the lowest level.

Rakesh Vyas:

Is there a constraint now on the kind of utilization that we can reach there?

S. Sankarasubramanian:

No.

Rakesh Vyas:

Everything else has been resolved?

S. Sankarasubramanian:

Yes.

Rakesh Vyas:

What is the proportion of Exports in our total business?

S. Sankarasubramanian:

Generally, our Sarigam technical 50%-60% goes to export market, 40% we sell it in the domestic market on B2B, for this quarter I have to get back to you on the exact number.

Rakesh Vyas:

Can you just highlight as to what change in the Mancozeb? You said Mancozeb sales is higher, pricing is also higher whereas rest of the people are highlighting that Agrichem exports have actually come down significantly. So what is the reason, can you just explain?

G VEERABHADRAM:

Two things have happened – one, Mancozeb as a resistance management molecule has gained importance. Globally, newer molecules develop resistance after two to three seasons. So Mancozeb is known for a good resistance breaking. So its use has gone up. Second, its label expansion in Latin America especially Brazil happened on the field crops. So therefore there is an explosion of volumes as far as Mancozeb is concerned.

Rakesh Vyas:

What is the total proportion of the traded products in the Export business?

G VEERABHADRAM:

Hardly anything now.

S. Sankarasubramanian:

Entire exports is our own manufactured product, there are no traded products.

G VEERABHADRAM:

Previously, we have chloropyrifos now almost nothing. Everything is manufactured.

Rakesh Vyas:

Even in Domestic Formulations sales are all manufactured?

G VEERABHADRAM:

Yes, in Domestic Formulations business it always happens- we buy some technicals from others and make it. That does not come under trading. Company makes some products and purchase some products. What we would do is just do trading by just taking in and changing the label, that sort of thing is not there with us now.

Rakesh Vyas:

Is there any other product apart from Mancozeb which is large in size or gaining traction for the status?

G VEERABHADRAM:

Acephate in the export markets performed well and Propineb is one of the molecules that has performed well. As a company, we have done reasonably well in Propineb exports. They are expected to move up further as we go forward.

Rakesh Vyas:

In Fertilizer business, what is the credit period now extended to the channel and were there any specific discounts offered in third quarter?

S. Sankarasubramanian:

We operate different price scheme for each state depending on the competition and our level of sales what we do. Predominantly, we do not offer any discounts in the southern markets where we have a strong brand presence. But in the northern markets where our market share is not significant, we do compare it and benchmark with the competition. But we always try to be a price leader in most of the markets where we operate. In terms of our credit period, it ranges between 60 to 90-days.

Rakesh Vyas:

Has that moved up because of the inventory levels or this has been the consistent strategy now?

S. Sankarasubramanian:

In some states like Karnataka and Maharashtra where the monsoon situation is not good, it has been sort of a stretch there. But that is also a reason why our sale volumes are down in those markets.

Moderator:

Thank you. The next question is from the line of Sumanta Khan from ICICI Prudential Life Insurance. Please go ahead.

Sumanta Khan:

My question is on your interest cost line. It might come down as the year progresses, but it remains virtually flat on a 9-month basis YoY. There have been some different rates and systems. So do you think any benefit will come down in the next few quarters?

S. Sankarasubramanian:

Two things what we predicted did not happen – first, we produced anticipating a good market situation and that did not play out the way we wanted. That resulted in building up of our own inventory. Our field finished goods as well as raw material stock holding are high on nine months basis compared to what we generally prefer. Ahead of the season we wanted to be ready with the products so that we do not lose opportunity but market turned out other way. So this will get corrected and we have already started correcting this and moderated our procurement as well as the production. So going forward that should get eased out as far as the inventory goes. The other area where we expect significant reduction to happen is on the 10% subsidy element which is now close to Rs.850 crores. We thought that this money would be realized in the first quarter, that did not happen. That is one big ticket item which would definitely help us in easing out our interest cost. So as and when that plays out, that should bring down the financing cost. The third is that market is a function of demand and supply and monsoon situation. In the southern markets we are much better off, but in the northern markets there are significant outstanding and we do expect situation improves and with the moderation in sale, the collection will happen. So these three things -- moderation of receivables, bringing down of inventory and releasing of 10%subsidy -- will definitely bring about significant reduction in working capital levels and consequently the interest cost. Also in all other businesses like Specialty Nutrients or Crop Protection business we have definitely brought in a lot of market discipline and that started impacting us in terms of better working capital levels both for receivables and inventory.

Sumanta Khan:

If I look at your long-term P&L, there was once that your other expenses were around 10% of your sales and now it is around 14% and you have earlier also said a large part of it is because of the hedging cost which you have to take now. Has there been any improvement or do you see any improvement going ahead in this line item?

S. Sankarasubramanian:

This is again a function of liquidity. A part is reflected in the financing cost, a part comes in way of hedging cost. So once working capital cycle improves, definitely it should come down. In the past, we never used to incur this sort of hedging cost because the overall cash cycle would be much sharper and we could pay off the dollar liability. We have very tight Forex policy, in fact, during this quarter we moderated our approach and brought down our premium cost to a greater extent. At the same time we want to be very prudent on our exchange risk management and this will improve as and when the cash cycle improves and going forward we can see some reduction. We are also trying to focus on how better we can be in terms of managing our exposure. So we do expect some improvement will happen in the coming quarters.

Moderator:

Thank you. The next question is from the line of Balwinder Singh from B&K Securities. Please go ahead.

Balwinder Singh:

Firstly, if you can just highlight that what kind of volume and pricing growth Mancozeb has seen in terms of numbers?

S. Sankarasubramanian:

We do not want to put the number to it. But it has grown significantly in terms of volume. On the price side also, there has been an improvement. Also exchange rate coupled with price change helped us.

Balwinder Singh:

Assuming that most probably monsoons are likely to be normal in the current year. How do you see industry volumes growth in Fertilizers -- because inventory is now on the higher side, you see flat kind of industry sales growth or you see growth of 10-12% in industry volume?

S. Sankarasubramanian:

If you are talking about ’15-16, industry volume did grow during this year. DAP has grown by 23% and Complex has grown by 6%, but in terms of consumption because of the channel inventory it is almost I would say flattish, but that is because of the monsoon situation. So overall there is a positive trend, there has been price acceptance by the farmers at this price point for Phosphatics and there has been an increased traction towards Phosphatics considering the benefit it gives in terms of yield improvement. Volumes have grown even after correcting for the channel inventory volumes- it will be marginally lower or almost at same levels. Going forward, next year monsoon is going to be good, definitely we should see at least two-digit growth in Phosphatics till it gets back to normalize level of consumption. Right now we are at 15 to 16 million tonnes, so that should grow at least at a growth of 10% for the next two years before it goes into a normal growth rate of 3% to 4%.

Balwinder Singh:

That is despite the fact that we are carrying higher channel inventory this year?

S. Sankarasubramanian:

Actually I am ignoring the volume growth and sales in the current nine months and I am moderating for that in channel inventory. So I am assuming a flattish number of 15.5 million this year after adjusting for a channel inventory.

Moderator:

Thank you. The next question is from the line of Manish Mahawar from Edelweiss. Please go ahead.

Manish Mahawar:

My question is on Sabero margins. You said your margins are around 17-18%. Do we see this margin will be sustainable in the next year?

S. Sankarasubramanian:

We want to sustain them but some of the variables are structural. You are asking a question how long crude will sustain or gas prices can be sustained. If that is going to be true this will be true. It is a function of input cost, it plays a significant role. Whether rupee is going to 68+ then these also will sustain. Whether Mancozeb demand is going to be there? If answer is yes, and this will also sustain. So it is a function of variables which we feel at this point of time given our feeling we should be able to do and we are also doing many things to improve the margin structure for the plant operations.

Manish Mahawar:

But Sabero's sustainable margins I think you earlier mentioned around 15-16%?

S. Sankarasubramanian:

Correct, that is before Mancozeb gets into this volume growth. Even a technical B2B business in India should have this set of a margin structure.

Manish Mahawar:

You mentioned in your opening remarks, government announces a subsidy on Organic Manure business. Can you elaborate on that?

S. Sankarasubramanian:

Right now they have allowed the fertilizer companies to market Organic Fertilizers by giving Rs.1500 per tonne as a subsidy. Basically this will help in bringing down the price of the product in the end consumer farmers and that may result in volume increase and adoption of this fertilizer by more and more farming community. To us, it is positive from the point of view in terms of volume expansion.

Manish Mahawar:

But this notification with effect from date is still to announce, right?

S. Sankarasubramanian:

Yes, detail part of it still has to be announced. In-principle it has been approved by the government.

Manish Mahawar:

What is our cash from operations in the nine months versus last year nine months if you can give growth it is really good?

S. Sankarasubramanian:

I have to get back to you on this data, Manish.

Moderator:

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

Abhijeet Akella:

What is the current realization on Organic Manure that we have per kilo?

S. Sankarasubramanian:

It ranges between Rs.5 to Rs.7.

Abhijeet Akella:

Just on the Agrochemicals business, roughly what I understand is half of our total Agrochemicals sales would be Sabero and rest would be non-Sabero. So the exports part is roughly 60% of the Sabero part. Is that understanding correct or there is some other export also?

S. Sankarasubramanian:

There are some exports from our Ankleshwar unit of Coromandel, not very significant but fairly we can assume that 50% of the Sabero comes as exports.

Abhijeet Akella:

So essentially, out of the total Agrochemicals sales that we do, just the export component would be somewhere around 30-40%?

S. Sankarasubramanian:

You are right, but this 50% share is as of now less because of drop in traded volumes. So we can say on overall pie it maybe 35% to 40% including the total Formulations business of Coromandel everything put together.

Abhijeet Akella:

On the Gypsum plant that you mentioned it was closed because of the floods. Has it been restored now?

S. Sankarasubramanian:

Yes, back to operation long time back.

Rohan Gupta:

Just a couple of things from my side; what was the breakup of Fertilizer and non-Fertilizer in revenues if you can give?

S. Sankarasubramanian:

82 and 18.

Rohan Gupta:

With the recent currency volatility, do you see that our hedging cost will shoot up significantly in Q4 and if it remains there, then it can be significantly higher?

S. Sankarasubramanian:

Whatever rupee depreciation has to happen has happened by December/January. Now, we got used to this new norm of volatile currency. I would not say whether it will impact one quarter or two quarters. We have been actively watching it and we are managing it. We have to wait and see how it plays out till the year end.

Rohan Gupta:

During the call you also mentioned during this huge volatility you have lowered the amount of hedging which you used to do earlier. So what is the percentage hedging which we are doing now – how much of our exposure is hedged?

S. Sankarasubramanian:

Slightly we have improved our open exposure during this quarter in order to moderate our hedging cost, but these are all very dynamic decisions and we do not stick to one thing and overall we ensure that we do not take too much of open risk. We increased our open exposures by 30 to 40% during this quarter.

Rohan Gupta:

How much in terms of percentage open exposure will be?

S. Sankarasubramanian:

Fairly, we try to hedge once the material is shipped out. So to that extent we were almost hedging all the transactions in the past. We are moderating now.

Rohan Gupta:

With the huge inventory in the system, so even if we have 4.5 million tonnes sort of inventory in the system, then even if next year Kharif, assuming even if we start normal, then also probably we should not see a huge volume ramp up at our own manufactured facility, right?

S. Sankarasubramanian:

This has got nothing to do with our manufacturing capability because the products what we handle, what we produce, what we offer to the market and where we operate matters. If the monsoon and our addressable markets are going to be good and if product is accepted by the farmers, I do not see any reason why we should get impacted by the channel inventory. Of course, we will be more prudent in our terms of credit exposure, but we have a significant market presence in the key operating markets and we hope to do well.

Rohan Gupta:

This channel inventory is spread across the country in the same way or in the market where you operate it is slightly tighter than the other markets?

S. Sankarasubramanian:

This I would say is relatively lower in the market where we operate.

Rohan Gupta:

Thank you very much for giving us your valuable time.

S. Sankarasubramanian:

Thank you, Rohan.

Rohan Gupta:

On behalf of Emkay Global, I also thank all the participants who have logged in for the concall.

Moderator:

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

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Emkay Global Financial Services Ltd.

CIN - L67120MH1995PLC084899

7th Floor, The Ruby, Senapati Bapat Marg, Dadar - West, Mumbai - 400028. India

Tel: +91 22 66121212 Fax: +91 22 66121299 Web: www.emkayglobal.com

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