

Transcript

Conference Call of Shasun Chemicals and Drugs Limited

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Presentation Session

Moderator:

Good evening ladies and gentlemen. I am Gopal, moderator for this conference. Welcome to the conference call of Shasun Chemicals and Drugs Limited. We have with us today Mr. N. Govindarajan, CEO and MD of Shasun Chemicals Limited; Mr. S. Vimal Kumar, Whole time Director of Shasun Chemicals Limited and Mr. Vinod Jain, General Manager Shasun Chemicals Limited, along with Mr. Somnath Iyer, CFO of Shasun Chemicals Limited. At this moment, all participants are in listen-only mode. Later, we will conduct a question and answer session, at that time, if you have a question, please press * and 1 on your telephone keypad. Please note this conference is recorded. I would now like to handover the conference to Mr. Vimal Kumar, please go ahead sir.

Vimal Kumar:

Thank you Gopal. Good evening friends. This quarter was the worst quarter in the history of Shasun. The results were negative mainly due to the two-fold impact. One was for the UK operations where the sales revenue was lower than the budget. The impact was mainly due to deferral in sales. Coupled with that, in Indian operations, we saw the peak in ibuprofen raw materials prices and also the availability became critical, impacting production. Overall for the year, the management is confident to maintain growth compared to last year, both in India and in the UK operations.

We would be able to wipe out the losses in the second or third quarter, we are still confident of making up in the coming quarters for the current year. I think with this, I will leave the floor open for question and answer session. Thank you.

Question and Answer Session

Moderator:

Thank you sir. Ladies and gentlemen, we will now begin the question and answer session. If you have a question, please press * and 1 on your telephone keypad and wait for your turn to ask the question. If your question has been answered before your turn, and you wish to withdraw your request, you may do so by pressing # key.

First question comes from Mr. Nimish of Motilal Oswal Securities Limited.

Nimish: Yeah, Good evening everybody.

Vimal Kumar: Good evening.

Nimish: Quickly some questions, one is you said, UK operation sales were lower, what is the specific reason, I didn't get it?

Vimal Kumar: As such, even during the budget, it was budgeted around 9 million, but we ended up around 7 million pounds and about 2 two million pounds deferral happened to second quarter and which is on track now. It was due to the raw materials specs not meeting the standards.

Nimish: Okay. So, it is a two-fold impact, raw material supplies also didn't come on time and plus there were sales deferral or the two are linked, because raw materials were not available, the sales got deferred?

Vimal Kumar: It was mainly due to raw materials not meeting the specs and had to be reordered. And in any case, the first quarter budget was about 9 million pounds as against we did 7 million pounds. And at 9 million pounds itself, we were looking at some losses, but not to this extent.

Nimish: Okay and are you confident that whatever you have lost in terms of revenues, you will be able to make up in the coming three quarters?

Vimal Kumar: Yes. The 2 million would be made up even in the second quarter itself, I don't see that as an issue and we are still confident of going as per budget so far.

Nimish: So, in that sense, what are we expecting for overall UK business for FY09?

Vimal Kumar: Overall, we are expecting a very marginal growth of 1% or 2% on topline and almost flat at the bottom line as last year.

Nimish: And flat bottom line last year is excluding release of negative goodwill or post impact of the negative goodwill?

Vimal Kumar: Yeah, this year, we will have a very marginal release of negative goodwill as against 1 million pound last year. This will be only about 300,000 this year. In spite of that, it is expected to

achieve about 1 million pound PAT from UK operations. This is mainly due to some cost-cutting exercise, cost-optimization exercises, which have been undertaken and which have been identified for the year in UK operations. So, that would help us in posting profit there.

Nimish:

But, I would believe that since now there is considerable time has passed since this acquisition in UK, the assumption here is that you would have taken whatever cost-cutting that had to be done would have been already through I think, I mean, is there still room left for cost-cutting, that's what I want to know?

Vimal Kumar:

The exercise of identifying the opportunities for cost cut started last March and therefore we will see full year impact this year.

Nimish:

Any specific areas on the cost side, which you don't want highlight where you are controlling cost?

Vimal Kumar:

One is reduction in number of people who were hired last year to handle the molecule which is in phase 3 and now that they will be lying idle till the production is launched.

Nimish:

In that connection, would you be incurring any major one-time separation cost, because I believe, reducing staff in UK is not all that easy?

Vimal Kumar:

These are the temporary workers or contract workers and we don't see any issues in that and it will not cost us any additional expenses. And apart from that, there are other areas such as energy saving, waste management etc. With all these, this is what would help us to have a better gross profit margin.

Govindarajan:

Just to be more specific on the manpower Nimish, the rule clearly provides that anybody who has been appointed on the temporary basis or the trainee basis doesn't really call for any upfront payment for us to release them.

Nimish:

Okay, understood, fair enough. And just one more question on UK before we move on to the India operations is, although first quarter numbers are not all that great for the UK operations, are we fully confident that there is no issue from the customers end or there are no major contracts which are trending downwards, its only an issue related to raw material, which is getting resolved over the next few quarters, is that understanding correct?

- Govindarajan:** That's correct Nimish. Basically, we have not had any issue in terms of any of the contract in the sense that none of the contracts have been dropped. But there are deferrals, which are occurring in terms of one quarter to the other quarter in this contracts and that is what we are addressing and we are clearly confident in terms of those maturing in the subsequent quarter is what I would say and even though there are certain products, which were on the pipelines, yes, there are deferrals in terms of even the phase 3 molecule, but then they are still on track.
- Nimish:** Okay and when you say that you face raw material issues for your UK operation, are we to understand that a supply of raw materials fell short of your expectations or is there some other issue related to raw material, I mean, I didn't get it, what would you mean by raw material issue?
- Govindarajan:** Okay, the issue was, this was specific to one particular customer and one particular major product. This is where the customer was to supply the raw material, the starting material. Starting material failed the specification and for that replacement, it took almost 35 days and that's came towards the end of the quarter and that was our major issue that happened.
- Nimish:** Okay, okay. But this raw material is supplied by the customer itself?
- Govindarajan:** Yes, the customer gets it done and he supplies it free of cost to us.
- Nimish:** Okay fine. Now moving on to India operations, you mentioned something related to ibuprofen impacting the numbers, I mean, could you be more specific, what has exactly happened here?
- Govindarajan:** The ibuprofen raw material costs have tremendously gone up, thanks to the Chinese situation as well availability of certain other raw material became critical. We have negotiated with our customers and would now be able to completely pass it on to the customers. .
- Nimish:** And any other issues, which would have impacted your topline in the current quarter or these were the only issues, ibuprofen and...?
- Govindarajan:** Again, when I said raw material is not only the specific to ibuprofen, the major impact is on ibuprofen because of the topline which typically had more from the ibuprofen and other

raw materials also had issues, which would get normalized as we proceed to the subsequent quarter Nimish.

Nimish:

Okay. But, as you said, raw material prices are higher and that is creating some problems, so even if the situation were to correct itself in the coming quarters, are we to assume that margins will be under pressure or you would be able to pass on the higher raw material costs on to the customers?

Govindarajan:

I think we still are confident about passing on the major portion of the particular price increase immediately; it may not be 100%. So, the margin need not be completely under pressure even though it can be under a little pressure. So, there would still be growth compared to last year that is for sure. But at the same time, can we pass on 100% of all the raw material impact, the answer is no. So, we have to work towards optimization to still target for whatever we have budgeted for.

Nimish:

Then how would you be planning to recover the lost margins? Because, I mean, our margins itself are not all that high for which would offer you any room to kind of recover the loss margin.

Govindarajan:

Nimish, I think, while we are talking about this particular raw material impact, I also wanted to clarify that when we had met all of you, we had clearly said the first and second quarters were going to be bit of under pressure because we expect the majority of the business from the finished dosage facility to occur more from the third and fourth quarters. So, the raw material cost is not the only reason for us to have this bottomline impact and we are expecting our finishes dosage facility to get better capacity utilization from the third quarter of the current year and towards the end of the year, it really reaches a good potential. Those are something which adds to the bottomline while our expenditure would still be on during the current quarters. That answer's your query, Nimish?

Nimish:

Yeah, that does. So, in overall sense, what are we expecting for the India business or your Indian operations excluding UK?

Vimal Kumar:

In terms of growth, we are looking at 13% growth on topline and about 15-20% growth on bottomline compared to last year.

Nimish:

13% topline?

Vimal Kumar:

Topline yeah.

Nimish:

Okay and 15-20 on bottomline?

- Vimal Kumar:** That's right.
- Nimish:** Any update that you can provide us, one, on the FOREX loss that you booked in the quarter and secondly, the CAPEX plans both in India and UK?
- Vimal Kumar:** Yeah as far as FOREX losses concerned in India in first quarter, the reinstatement losses ran to the extent of almost 4.8 crores.
- Nimish:** 4.8 crores is the translation loss?
- Vimal Kumar:** Yes. And about 2.5 crores loss was due to forward contracts, which we have booked earlier at 41
- Nimish:** So, 2.5 crores is the actual FOREX loss and 4.8 crores is the non-cash translation loss, is that the way we should look at it?
- Vimal Kumar:** That's correct.
- Nimish:** And this 4.8 crores translation loss, where does it arise from, is it because of foreign currency debt you would have or?
- Vimal Kumar:** To the extent of 2.37 cr is CAPEX borrowing and 2.4 crores is net current asset.
- Nimish:** Net current asset. Okay. So, these 4.8 crores if I were to understand correctly, will have to be mark-to-market every quarter depending on the movement of the currency?
- Vimal Kumar:** Yeah that is correct.
- Nimish:** Okay. Okay and as of now how are you hedged in terms of forward covers, since you said that forward covers you would have actually booked a loss?
- Vimal Kumar:** Even at the beginning of the year, we were like almost booked 70% of our export turnover at 41 averages.
- Nimish:** Okay.
- Vimal Kumar:** And that position continues and effectively we are not able to enjoy the current valuation of the rupee.
- Nimish:** Yeah. So, when would be in a position to actually take the benefit of the rupee depreciation that you have seen recently? Assuming that the rupee stays at current level throughout the

year, should we accept this complete year you will not be able to enjoy the benefits?

Vimal Kumar: Like I said, 70% of this year's targeted turnover was booked at 41. So, only about to the extent of 30% will be enjoying that current rate.

Nimish: Okay and now given the current movement of the rupee, is it fair to assume that you are not taking any incremental hedges now?

Vimal Kumar: No, we are not taking, but sometime at peak rate, definitely we would look at doing forward for the longer term.

Nimish: Right and the update on CAPEX plans?

Vimal Kumar: As far as CAPEX plans are concerned, in India definitely we have slowed down the Vizag process.

Nimish: Okay.

Vimal Kumar: And we would like to take it up later part of the year, so the outgo would be minimal. Apart from that, we have taken up major exercise of converting our existing furnace oil boiler to the alternate fuel, which would involve about 15 crores expenditure and another 20 crores normal CAPEX this year.

Nimish: That is 35 crores.

Vimal Kumar: 35 crores.

Nimish: Okay and UK?

Vimal Kumar: UK, right now it is about 2 million pounds is budgeted, sanctioned and we will be looking at further CAPEX expenditure based on customer's contribution and based on each project requirement.

Nimish: Okay and the last question is what would you give us as an overall guidance consolidated topline and bottomline for current year?

Vimal Kumar: Consolidated, we would look at about 10% growth on topline.

Nimish: Okay.

Vimal Kumar: And it is just about 10% to 12% growth in bottomline

- Nimish:** Okay fine. I will fall back in queue. Let others ask some questions.
- Vimal Kumar:** Thank you Nimish.
- Nimish:** Thank you.
- Moderator:** Next question comes from Mr. Kartik Mehta of MF Global.
- Kartik:** Yes. Can you share with us the number of, that is, amount of total debt that you would have on 30th June and what would be rupee and what would be non-rupee on a consolidate basis? Thanks.
- Vimal Kumar:** Yeah. Consolidated basis it is about 270 crores and as far as India is concerned 128-130 crores is what Indian side.
- Kartik:** Thanks.
- Moderator:** Next question comes from Mr. Nath Balakrishnan of Spark Capital.
- Nath Balakrishnan:** Yeah. Good evening gentlemen.
- Vimal Kumar:** Hi, good evening Nath.
- Nath Balakrishnan:** Yeah. How are you?
- Vimal Kumar:** Fine Nath.
- Nath Balakrishnan:** Sir, I will start off with the UK operations first before moving on to India.
- Vimal Kumar:** Yes.
- Nath Balakrishnan:** So, if I gather what was mentioned during the course of our last interaction, I think we were budgeting from doing about 55 to 56 millions pounds out of Rhodia for this year.
- Nath Balakrishnan:** Now, you did mention earlier that the budget was 9 million; we fell short by about a couple of million pounds and did 7. So, would it be fair to presume that we would end the year at Rhodia at about 51 to 52 odd million pounds?
- Vimal Kumar:** Nath, I think I should correct you here. I was projecting about 5 to 7 maybe minimal growth in the beginning of the year in UK. It was about 48 to about 52 to 53. Our revised target would

now look like around just about 2%, 49 or 50 and with the cost-cutting exercises, we would be able to maintain a little higher growth as far as PAT is concerned.

Nath Balakrishnan:

Sure. Secondly, on the contribution margin from Rhodia, Now, at least we notice that in this quarter it is up sharply because you have normally guided for a contribution margin of something like 65%. Whereas in this quarter, it has gone up sharply to almost 85%. A) Wanted to understand whether this is sustainable or B) it is an aberration.

Vimal Kumar:

No Nath, I would still guide for that average of 65%. It all depends on the product mix we take every quarter.

Nath Balakrishnan:

Sure.

Govindarajan:

In first quarter, specifically there is a service contract, which I added more to the bottomline mark.

Nath Balakrishnan:

Okay and then coming to the other aspect of cost on Rhodia, I think the combination of people cost and other expenses. Now, typically, I think historically, over the past four quarters of last year, the total has averaged above 65 to 68 crore per quarter, if my memory serves me right. Now, we noticed that you know HR costs have gone up significantly. It used to be 33 crore per quarter. It has gone up to 41 crore per quarter this time around. I wanted to understand whether it was because you said you are going to rationalize work force, was there any severance-related payment that was made this quarter?

Vinod Jain:

I just need to correct. There was a grouping issue in terms of the employee cost and other expenditure. So that needs to be corrected and it should read as, the employee cost for the quarter would read as 44.7 crores and compared to previous year quarter of 43.83. The other expenditure would be reading as 49.49 crores as against 60.84 crores last year.

Nath Balakrishnan:

No, can you come again on that numbers, I cannot hear you?

Vinod Jain:

See, as far as employee cost is concerned for the quarter, the consolidated number to be read as 44.7 crores.

Nath Balakrishnan:

No, this is consolidated is it?

Vinod Jain:

Yes.

Nath Balakrishnan:

No, I am looking for the numbers for Rhodia alone, employee and other expensive for Rhodia.

- Vinod Jain:** That is 4.025 million as against average 4 million every quarter.
- Nath Balakrishnan:** Okay, and what about other expenses at Rhodia
- Vinod Jain:** It is 3.358 million.
- Nath Balakrishnan:** Okay. Sir, if you could just give us some update on the molecule in phase 3 in terms of what you are hearing from your client and any clarity in terms of time lines of launch and so on?
- Govindarajan:** Yeah, we are still expecting the customer to be on target in terms of the beginning, I mean, rather October 2010.
- Vimal Kumar:** No, no beginning of 2010.
- Govindarajan:** 2010, sorry yeah.
- Nath Balakrishnan:** Okay, in terms of revenue opportunity, we should still see about 12 millions euros out of this product at peak?
- Govindarajan:** At peak, yes your numbers are right.
- Nath Balakrishnan:** Yeah, 12 million euros then.
- Vimal Kumar:** I would correct here, it is 12 millions pounds Govind, and it is not in euros. Nath, at peak, we could expect 12 million to 15 million pounds out of this product.
- Nath Balakrishnan:** Sir, if you could just tell us when do you expect to hit peak supplies on this molecule post-launch, how many years it would take?
- Govindarajan:** I think, as far as the post-launch is concerned, we are expecting this to be reached in the second year itself.
- Nath Balakrishnan:** Post-launch in the second year is it? Okay, I think, I will just move on to India operations now sir. What is the reasonable expectation for what we would do from the Indian business in FY09?
- Vimal Kumar:** Like I said, we are expecting about 13% growth here of topline and about 15% to 20% in bottomline in the current year.
- Nath Balakrishnan:** And we also maintain the view that growth is going to be back-ended because I remember Mr. Govindarajan having mentioned in the earlier call that the formulations business will kick-off from second half onwards. Is that still valid?

- Vimal Kumar:** That's absolutely valid Nath.
- Nath Balakrishnan:** Okay, sir just on an overall number, on a consolidated number basis, we have done 24.6 crore earns for 08, but off course that includes negative goodwill, so sustainable earnings of about 15 to 15.5 crores, if you let off negative goodwill, what are we looking at in terms of earnings for 09 in the context of 30 crore loss in the first quarter?
- Vimal Kumar:** Our target is consolidated with release on negative goodwill of 300,000 pounds is about 32 to 33 crores.
- Nath Balakrishnan:** But this includes negative goodwill?
- Vimal Kumar:** That's correct.
- Govindarajan:** Of 300,000 pounds Nath.
- Nath Balakrishnan:** So, in a sense what we are saying is that we are looking at quarterly run rate in terms of earnings of 20 crore over the next three quarters?
- Vimal Kumar:** Again, it won't be evenly distributed; it would be more towards third and fourth quarter.
- Nath Balakrishnan:** okay, thanks sir. I will jump back into the queue.
- Moderator:** Next is a followup question by Mr. Nimish of Motilal Oswal Securities Limited.
- Nimish:** Yeah, just a couple of more questions, one is, does the company need to raise more money for its future plans?
- Vimal Kumar:** Yeah, marginally, we would be resorting to some loans, yes.
- Nimish:** Loans?
- Vimal Kumar:** Yeah.
- Nimish:** How much would be the incremental debt over 270 crores the figure that you gave us or rather to divert the question what would you end the year with in terms of debt?
- Govindarajan:** Debt would be marginally higher by
- Vimal Kumar:** It is about 12 to 13 crores because there will be some repayments and we will be looking at 285 crores maximum.

- Nimish:** Okay and no equity dilution in the foreseeable future?
- Vimal Kumar:** No, nothing is planned as yet.
- Nimish:** Nothing is planned and sir the promoters had subscribed to warrants, now what is the status on these warrants, because we have not received any updates on this?
- Vimal Kumar:** No, about two quarters back the updates were reported that the originally the application was pending for a longtime with BSE for some issues and finally we have decided to withdraw at that point in time itself and the recent, whatever the advanced money was received, refunded to all the directors and were paid. It was informed to all SEBI and Exchange.
- Nimish:** Oh! Then maybe I have missed out on that. So, now the warrant issue is not outstanding.
- Vimal Kumar:** No, nothing is outstanding.
- Nimish:** Nothing is outstanding. Okay, fine, thanks a lot.
- Vimal Kumar:** Thank you Nimish.
- Moderator:** Next is a followup question by Mr. Nath Balakrishnan of Spark Capital.
- Nath Balakrishnan:** Just also wanted to understand, how are you seeing FY09, of course, you have given a broad guidance, but how do you see FY10 planning out, if you could discuss Rhodia and the India business separately?
- Vimal Kumar:** Let me take the Indian operations first, where the major growth is coming from formulation and the CRAM business in India. And whatever contracts we are negotiating now and which would give us the projected sale of about 60 crores this year and would mean about, at least those contracts itself should mean about 80 to 90 crores in a full year basis.
- Nath Balakrishnan:** Sir, this is only the formulations business?
- Vimal Kumar:** Only the formulations business.
- Nath Balakrishnan:** 60 crore in 09 and 80 crore in 10.
- Vimal Kumar:** No, what I said was 80 to 90 crores of those contract, which we would be starting of this year. Thus, we should be able to do another 20 to 30 crores next year, which would mean about

anywhere from 110 to 120 would be our target for next year in formulation and as far as CRAMS is concerned, we are definitely targeting 40% growth year-on-year, compared to last year and that would be the major growth drivers for India. In UK, of course, two products would be launched starting from next year, one is intermediate next second half of the next calendar year and of course in 2010 beginning, we are still targeting the launch of this major molecule of phase 3.

Nath Balakrishnan:

Okay, but in 10, would it be safe to assume that you would do close to about 55 million pounds out of UK, 10% on what you do this year.

Vimal Kumar:

Ya, if everything goes well, we should be targeting at least 15% growth.

Nath Balakrishnan:

No, what I am doing here for the moment sir, I am setting aside the opportunity from the phase 3 molecule, I am looking at only the core business, of course that is being built is separately.

Vimal Kumar:

But Nath, we have been booking some revenue out of this products also for the last two years including this year.

Nath Balakrishnan:

Okay, no, this is because you had the stake of pay contract initially?

Vimal Kumar:

No, that was initially, this year, as per the agreement, we have with them, there will be also some reservation fee, which they will be paying apart from some molecule, some process will be consuming for the validation batches. So, we would be booking like I said the earlier about almost 6 to 6.5 million pounds as compared to 8 million pounds we did last year and that's on that particular molecule.

Nath Balakrishnan:

No, sorry to interrupt there, but prior to this commercial launch, which you expect in the last quarter of FY10, would this 6.5 million pounds recur next year as well?

Vimal Kumar:

Ya, 6.5 is minimum, in case if it gets deferred again that would still remain.

Nath Balakrishnan:

Sure, sure okay.

Vimal Kumar:

I think, I have made the question clear.

Nath Balakrishnan:

Yeah, okay and what could be your CAPEX plan in 10 across both India, I heard you mention plans for 09, but what it would be in 10?

- Vimal Kumar:** Ya, the next year definitely Vizag is the major portion, which would be about 80 crores and apart from that we should have another in India, 20 crore would be normal, 100 crores in India and about 30 to 40 crores in UK.
- Nath Balakrishnan:** But what would be the CAPEX in UK meant for sir, what it would be this for?
- Vimal Kumar:** Like I said UK, we are spending more with customer needs and where we ask customer to participate in the CAPEX, so that they are committed.
- Nath Balakrishnan:** Okay, this would be part of it funded by customers directly?
- Vimal Kumar:** Yeah part of it, but what figures I am saying would be our next investment.
- Nath Balakrishnan:** So, you are likely to end FY09 with debt of about 285 crore, what would that number look like end of 10?
- Govindarajan:** Okay, Nath, I think that I will have to really work on and get back to you.
- Nath Balakrishnan:** Okay I will touch base with you sir. Thanks.
- Moderator:** There are no further questions. Now, I hand over the floor to Mr. Vimal Kumar for closing comments
- Vimal Kumar:** Thanks Gopal and thanks everyone for having participated in such a short notice I would say. Let me also take this opportunity to introduce Mr. Somanath Iyer, who has recently joined Shasun at CFO. Somnath, if you can just be in touch, probably next time when we meet personally, I can introduce him and meanwhile Somanath would like to add anything?
- Somanth Iyer:** No, I just joined them, so probably if they are any more questions you have feel free to contact, I should be responding to you. Thank you.
- Vimal Kumar:** Thanks everyone.
- Moderator:** Thank you Sir. Ladies and gentlemen, this concludes your conference for today. Thank you for your participation and for using Door Sabha's conference call service. You may disconnect your lines now. Thank you and have a pleasant evening.

Note:

1. This document has been edited to improve readability.
2. Blanks in this transcript represent inaudible or incomprehensible words.