



“Vardhman Special Steels Limited Q1 FY2019 Earnings Conference Call”

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Moderator: Ladies and gentlemen good day and welcome to the Q1 FY2019 Vardhman Special Steels Limited earnings conference call hosted by Edelweiss Broking Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should 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 now hand the conference over to Mr. Harsh Shah from Edelweiss Broking Limited. Thank you and over to you Sir!

Harsh Shah: Thank you Lizaan. Good afternoon everyone. On behalf of Edelweiss Broking I welcome you all to the Q1 FY2019 results conference call of Vardhman Special Steels Limited. On the call we have with us Mr. Sachit Jain, Vice Chairman and Managing Director and Mr. Sanjeev Singla, Chief Financial Officer of the company. I now hand over the call to the management. Over to you Sir!

Sachit Jain: Thank you. Good afternoon ladies and gentlemen. Thank you for all of you for being here with us on this call. With me, Sanjeev Singla, our CFO, Bridge, our Investor Relations team from Bombay, and from our corporate office, the corporate finance team and investor relations’ team, Jasmeet and Poorva who look after the group’s finance as well as investor relations.

Overall this has been a decent quarter, volumes have been 41587 tonnes, 12% increase over last year first quarter and revenues have gone up to Rs. 269.5 Crores, 33% increase over last year first quarter and net profit of Rs. 9.08 Crores, decent increase from last year’s first quarter. Basically we got the Rs. 4000 price increase per tonne from April 1, 2018, as all of you know that we are only in the automotive steel industry and the price increases or decreases happen every six months, so April price increase would depend on the average increase of the last six months, which means October to March, average price increase and similarly when the decrease happens it will be the previous six months average price in a falling price scenario.

In a rising price scenario, the margins will be squeezed a little bit from what they should be as happened in the first quarter, so overall we have also been working on our production capacities as I shared with you earlier on a month basis we have touched the capacity of 200,000 tonnes of melting. Also we are now fully confident of 200,000 tonnes of rolling capacity. We have an expansion currently underway. We have a shutdown, which was scheduled for January, but it is getting postponed to March or April. After which our melting capacity will shoot up to 240,000 tonnes. Rolling will be at 200,000 tonnes and over the next three years we intend to improve that to 225,000 tonnes.

Overall the demand continues to be robust we are not able to meet fully the requirements of the market so we have to say no to certain customers. As a result of which we have started the process of getting material done on job work from outside for different types of customers and this activity will pick up stream really from third quarter, so second quarter we started this activity. We will be reporting this as separate line item from the second quarter results because

first quarter they were hardly any sales in this area and this is going to become gradually a bigger share of our business because we do not want to lose shares at this point in time.

Auto sales continue to be robust and that is driving the demand to other products. We are reasonably confident that increased capacity of 225,000 tonnes we will get in three years' time we will be able to fully utilise this capacity over the next two to three years. On the government incentive today, the Government of Punjab has announced for the new investment policy the guidelines. The guidelines are in line with what we were wanting and hoping for, in fact the Chief Minister is having a conference tomorrow in Ludhiana to officially launch these guidelines. With this, that means, the current expansion plan will get covered under this new guideline which will give us good incentive, the moment we complete this expansion which will be sometime middle of next year; however, this also signifies that there is possibility of revising the previous policy favourably from what is announced so far, that possibility exists but till that happens we are not taking any credit for that so far.

The focus in terms of future growth we are continuing our search for the technical partners, discussions are still going on, that is all I can say, with many of these international companies it takes years to find a right partner and after finding the right partner to continue discussions and to be able to come to some conclusions, so that process is on. This is very high item on my agenda.

I would say really that the first phase of our company's growth plans starting from when they began in 2010 when I got involved in the steel business; I will officially close that by April or May of next year with completion of this project of expansion. The second phase the process has begun, which is more value addition in downstream the potential JV that we are looking at as well as the technical partner that we are looking at in the new plans once we find such a partner to formalise those new plans.

Two major events that have happened that we have got upgraded by CRISIL to AA and as promised to shareholders earlier, as indicated earlier, the board has yesterday approved, the change of auditors to BSR & Company, I believe, they are an affiliate of KPMG. So this was an assurance he had given to our institutional investors when we did the QIP that we intend to change the auditors. The older auditors continue in the company as tax auditors so they are not leaving in any bad phase or any such thing. It is just that they understood and we explained to them that with the institutional shareholders coming in we want to move to one of the big four so that is how the board on Saturday finalised BSR & Company.

This is all I have to say at this point. One more thing, we are planning a physical meet sometime in November so after our half yearly results we will be having a physical meet of Vardhman Special Steels in Mumbai. Open for questions now.

Moderator: Thank you. Ladies and gentleman, we will now begin with the question and answer session. The first question is from the line of Dhruv Agarwal from Crecita Investments. Please go ahead.

Dhruv Agarwal: Good afternoon Sir. Congratulations on a good set of numbers. Sir, my question is just to reiterate some data points from the fourth quarter of FY2018 concall, Sir how do you see volumes as for the full year FY2019 panning out?

Sachit Jain: We believe we will be between 165000 and 175000 tonnes so last year was 152000 tonnes, so we should be between 165000 and 175000 tonnes.

Dhruv Agarwal: For the first quarter as per my calculation, the realisation per tonne is around Rs. 64800 so for the whole year what average levels do you see for the realisation per tonne number?

Sachit Jain: I would think maybe Rs 1000 more than this.

Dhruv Agarwal: Rs. 1000 more than this?

Sachit Jain: Yes, that is what I would presume, but this is just guesswork at this point in time.

Dhruv Agarwal: Correct. For EBITDA per tonne number as per my calculation it is around Rs.4300 for the first quarter.

Sachit Jain: It is Rs.4700 for the first quarter and for the full year we should cross Rs.5000. Let me explain why we are confident of that. First of all, there are three factors which influence the EBITDA per tonne, one is of course increasing volumes, then the ladle refining furnace, which is getting commissioned in early October, the 200000 tonnes capacity that you are talking about in the melting just now we will hit it in the sporadic month, but to ensure it happens consistently this is important investment, which is getting commissioned in early October. So second half clearly the production capacity is going to be higher than the first half. Second, the raw material prices have been rising even in April and May, which means that margin in the first quarter are little depressed than what they should have been. This will continue in the second quarter. The second quarter like will be little lower than the first quarter and then October 1, we are likely to get the price increases based on the first half price raises.

Dhruv Agarwal: Okay, that would be more.

Sachit Jain: So second half would be better in terms of margins because this is rising price scenario, however, now the raw material prices seem to have stabilised, so they have fallen a bit and stabilised. So we believe that the peak has been reached and it is at a plateau stage now, of course we can be proven wrong, but as of now that is the situation, so with that thing, the second half looks to be more robust on the margins side because of raw material price increase which we were expecting from October; however, it depends on finally getting it in the hand, but as of now our expectation is we should get a price increase in October based on this raw material price cost increase. The third factor is power. From power point of view, the lowest cost of power is the fourth quarter, the second lowest is third quarter, the third lowest is the first quarter and the highest power cost is the second quarter. So as a whole second half power cost is significantly lower than first half power cost. So these are three elements which all lead to the second half expected to be

significantly better than the first half. You will see that in last year also. So if you compare the first half to first half. First quarter we have got Rs.4700 EBITDA per tonne, first half last year was Rs.3800 EBITDA per tonne. Second half EBITDA per tonne last year was Rs.5100. So the same situation is going to play out even this year that the second half EBITDA per tonne would be higher and as of now first of all our guiding range is 4500 to 6000, that is the guiding range.

Dhruv Agarwal: 4500 to 6000 correct.

Sachit Jain: But we believe that we will be north of 5000 for the full year. Second quarter is likely to be lower profitability than first quarter.

Dhruv Agarwal: Sir on an average for the whole year where do we see EBITDA margin, will it be back in the range of 9%.

Sachit Jain: I do not look at percentages so I doubt it will be at 9% because price scenario, we focus on EBITDA absolute number, not EBITDA percentage.

Dhruv Agarwal: Correct, you track it on a per tonne basis. Okay. Thank you so much Sir.

Moderator: Thank you. The next question is from the line of Ritesh Poladia from Girik Capital. Please go ahead.

Ritesh Poladia: Thanks for the opportunity. Sir my question pertains to the slide no.35 on capacity expansion. This Rs.200 Crores capex, this is for what incremental capacity?

Sachit Jain: See this is a combination of several things. So it is going to be 240000 to 250000 of melting plus 225000 tonnes of rolling, 225000 to 235000, it is difficult to put an exact number, but around the phase of rolling plus normal capex plus increase in bright bar capacity plus the new land that we have bought plus normal capex plus safety equipment plus R&D so the combination of all these things plus some investment for quality enhancement.

Ritesh Poladia: So incrementally ideally you are increasing about 40000 tonnes?

Sachit Jain: From 152000 tonnes to 225000 tonnes, which is almost 70000 odd tonnes of increase in sales. So 50% increase in sales.

Ritesh Poladia: So this Rs. 200 Crores capex is not a new capex, it is ongoing capex plus some more?

Sachit Jain: It is ongoing capex plus some more that is right.

Ritesh Poladia: So this year how much would be the capex and the next year please.

Sachit Jain: About Rs. 100 Crores would happen in this year, these are rough figures.

Ritesh Poladia: Already you have bought the land for Rs.32 Crores about Rs.80 Crores would be the next step?

- Sachit Jain:** At this stage, Rs.36 Crores and there will be some more investment is going, maybe in stamp duty we are still working out with the government if the stamp duty will be applicable or not, but 36 plus some more, it is about Rs.38 Crores I would say for the land. That is already paid.
- Ritesh Poladia:** Okay. So the next year would be about Rs.70 to 80 Crores which is firmed as of now.
- Sachit Jain:** I will not have those figures which are firmed or not, but over the next three years we are going to spent Rs.200 Crores, so Rs.100 Crores will be done this year and Rs.100 Crores over the next two years.
- Ritesh Poladia:** The last question on your technical alliance, by what rough-cut timeframe if you like to give us this would have played out?
- Sachit Jain:** I have been working on this for the last seven years, so it is very difficult to predict whether it will happen the next quarter or next one year or next two years?
- Ritesh Poladia:** That is all from my side. Thank you.
- Sachit Jain:** This has got my highest attention and my highest priority.
- Ritesh Poladia:** Thanks for giving opportunity. I am done with my question.
- Moderator:** Thank you. The next question is from the line of Venkat Rama from Orient Securities. Please go ahead.
- Venkat Raman:** Good afternoon Sir. Congratulations on a good set of numbers and thanks for the opportunity. I have one small question on the power cost pattern has shot up from Rs.7200 in Q4 to close to Rs. 8000 in the first quarter?
- Sachit Jain:** As I explained that fourth quarter is always the lowest power cost. So the reason for that is the Government of Punjab from October to March gives a night rebate of power tariff and in the period April to September, they charge a peak load, higher power tariff is peak load. This year, April and May they extended the night tariff so which is why the power cost was not as high as we had anticipated earlier. So that is one factor is the night tariff and the peak load in the period of six months. The second factor is Government of Punjab has lowered power tariff for incremental power consumption. Now incremental will always happen in the fourth quarter. So for both these reasons the power cost of fourth quarter and overall production has also been higher in the first quarter. So because of these three factors the power cost in the first quarter is higher than that of the fourth quarter. Second quarter the power cost would be even higher. Third quarter will drop and fourth quarter will drop below the fourth quarter of last year.
- Venkat Raman:** My question is what is your outlook on the pricing of graphite electrodes and scrap over the next year?

- Sachit Jain:** Graphite electrodes very difficult to predict because we are at duopoly situation, we are price-takers. The good part is that the Government of India under relentless pressure from the steel industry and of course in agreement with the graphite electrode industry, has agreed to remove the antidumping duty. So this is a relief on imported goods so that is one relief but beyond that I have no way of predicting where the electrode prices are going to reach. As far as scrap is concerned, the scrap prices have come down from the peak. The peak was about \$410 and it is down to about \$365 to \$370. However, the rupee has depreciated since then, but overall the shredded prices are lower than what they were. So I would say a pat, but very difficult to predict the game that what will take this prices up or down. So we do not spending much time in predicting these prices, we are buying every week.
- Venkat Raman:** Okay. Thank you Sir. That is it.
- Moderator:** Thank you. The next question is from the Dhawal Shah from Girik Capital. Please go ahead.
- Dhawal Shah:** Sir, my question will be from the slide no. 32 on the customer profile. Now, when you say the range you gave between Rs.4500 and Rs.6000 EBITDA per tonne, how would be EBITDA, how would the profitability differ between the different customer segments? In the future, if you want to?
- Sachit Jain:** The varying is from negative EBITDA per tonne to Rs.9000 EBITDA per tonne.
- Dhawal Shah:** Why would it be negative Sir?
- Sachit Jain:** It depends on some particular customer, some particular product. I would not like negative, but at times you see the customer profitability as a whole, to sometime you see a strategic advantage in dealing with the customer. Because if you have that customer in your portfolio, the possibility of getting other customers increases; it is a combination of all those factors. Ideally we do not like any negative EBITDA figures.
- Dhawal Shah:** Sir comparing automotive off-highway category with cars or two-wheeler. Is there any thumb rule that automotive?
- Sachit Jain:** We do not look at it that way.
- Dhawal Shah:** Okay, even some products in the cars category can give you a much better EBITDA compared to some other category?
- Sachit Jain:** Correct.
- Dhawal Shah:** Okay. So in order to increase our EBITDA per tonne your strategy would be to penetrate in all the segments of the customer profile?
- Sachit Jain:** Some of the customers who are low profitability to work on them if we can reduce the business or increase the pricing so selective price pressure to increase prices wherever possible that

attempt will always be made. We are finding areas of cost reduction wherever possible then as we increase bright bar business because bright bar is little more profitable in EBITDA per tonne, so increasing bright bar business. Looking at further some of the new developments that we are doing more specialised products where EBITDA per tonne would be higher.

Dhawal Shah: Okay so all the new developments will also be towards the automotive segment?

Sachit Jain: All our business is automotive so we have just secured our first export order from Japan so this is something we are feeling quite excited about.

Dhawal Shah: Wow that will be for which industry?

Sachit Jain: We do not share the details, but the fact is we are feeling very nice that we have exported steel to Japan; we have exported some steel to Germany. So these are two things, not large quantities, but it is nice bragging value that our team feels happy about so our collars are turned up today. Supplying to Japan would be something very valuable.

Dhawal Shah: Tiny quantity.

Sachit Jain: Tiny quantity, but it feels nice.

Dhawal Shah: Correct Sir. In terms of our customer market share are we at the top two or three in the leading names?

Sachit Jain: We are very small. We would be amongst the bottom two or three. We are very much smaller steel company. There are much bigger companies than us in terms of volume; however, in certain key customers our market share in a particular customer may be very high. There are customers where we have 85% share of their business.

Dhawal Shah: Sir just last question now from the industry perspective, what is the intensity of the competition like steel industry has it increased and what is the outlook for the next one year, full year?

Sachit Jain: Almost all the top company the high quality companies are all running full capacity. So there is going to be shortage of good quality alloy steel the way I see it.

Dhawal Shah: Okay.

Sachit Jain: However in the lesser quality companies there is capacity available. The question only is whether they will be able to penetrate into those customers or not, but the high quality companies are all absolutely full.

Dhawal Shah: What about the supplies out of the high quality companies Sir? Are they also expanding capacity to keep in with the same rate that the demand is growing or they are very cautious right now?

- Sachit Jain:** Everybody is cautious, but everybody is expanding in a small way and the market is growing faster than that. The threat eventually of the electric vehicle at some stage coming in is somewhere in the back of everybody's mind, which means the possibility of very large investments coming in this industry are relatively lower, but who knows.
- Dhawal Shah:** You need to take a while how long will it take it even?
- Sachit Jain:** That is the call we are taking.
- Dhawal Shah:** So overall the demand supply seems to be little tight over the next one to two years, this what you have informed?
- Sachit Jain:** As of today it seems like that.
- Dhawal Shah:** There is good time for us.
- Sachit Jain:** Again, as of today it seems like that.
- Dhawal Shah:** Experience is that.
- Sachit Jain:** Yes.
- Dhawal Shah:** Okay fine, thank you very much.
- Moderator:** Thank you. The next question is from the line Harsh Shah from Edelweiss Broking Limited. Please go ahead.
- Harsh Shah:** Thanks you. Can you just give some idea regarding the export, I know we have a small share, but it is a very rapidly expanding market also where we have great opportunities. Can you just throw some light on that, which areas, which regions, etc.?
- Sachit Jain:** So primarily our exports the biggest market is Thailand, the other markets that we have are Taiwan in a small way, Turkey, Germany, Italy and Russia. The other markets that we are exploring are Vietnam and Indonesia.
- Harsh Shah:** The second question is on the current domestic scenario where we are seeing some you can say volatile growth in all the segments overall in recent months, so where do you see the growth happening for individual segment, I am specifically asking for passenger vehicle and M&HCV?
- Sachit Jain:** See we are very small company, we are suppliers to this industry, and we do not waste our time to see whether cars are going to grow more or motorcycles are going to grow more. We are a very small company if we had 50% market share or 40% market share then yes we would be concerned about those things, we are 3% market share. At that market share, you just focus on being the best in customer service and quality and are producing right products and that is what

we have been able to do and so the demand for our product from us is more than what we can produce.

Harsh Shah: Any recent client addition in the last one or two quarters?

Sachit Jain: That goes on constantly.

Harsh Shah: So those new clients keep on coming.

Sachit Jain: The first question talking about margins, negative EBITDA or lower EBITDA so we are constantly culling out some such customers.

Harsh Shah: Great to hear that. Thank you and all the best.

Moderator: Thank you. The next question is from the line of Rahul Shah, an individual investor. Please go ahead.

Rahul Shah: Thank you for the opportunity. Please forgive for my bad throat. Just wanted to understand what are the reasons is it only the power low power tariffs for the second half which enables us to earn a higher EBITDA per tonne or are there other factors also which gives us some confidence that it will be higher?

Sachit Jain: I had talked about three factors. The volume in the second half is going to be higher than the first half and therefore the fixed cost will get spread over little bigger chunk, so that may or may not have any impact on EBITDA per tonne, but possibly a bit, it may have a bit. The second factor is we are expecting a price increase from October 1. The raw material is now plateauing out so which is why we expect that margin to go up and third as I already told you about the power cost being lower.

Rahul Shah: Just one another development which has happened, which is the export to the Japanese market that you have indicated so what does it lead us to in future. Do we see anything more substantial happening? Yes, if you can throw some light on that please?

Sachit Jain: One this is a very tiny business, so it will have no impact on the company apart from the fact that it gives tremendous goodwill and a feeling of motivation to our team that export into Japan. Two, this is through a new trading company a global trading company but it is our first business through this trading company. So this opens up a new chapter, new possibility of new customers coming in for this company. So this customer particularly may or may not have a huge impact, but this trading company coming in starting business with us can lead to more businesses in Indonesia and Vietnam or possibilities of also some strategic alliances. All those possibilities open up. Once you start a business commercial relationship with a global giant that is good enough for me. I will look at it just as more possibilities opening up. There is nothing concrete.

Rahul Shah: That's fair. Just one last question about pending acquisition that we have been planning of? Any thought on that, any progress on that side.

- Sachit Jain:** This is a slow and long process, which will continue in terms of discussions, stocking, thinking and so on so as a beginning we have started the process of more and more material done on job work we are starting now and if that proceeds satisfactorily over the next year or two we will have an opportunity to get something, but nothing coming in the next year. Anything if at all happens it is about two years out.
- Rahul Shah:** That is fair Sir. Thank you very much for the opportunity.
- Moderator:** Thank you. The next question is from the line of Dhruv Agarwal from Crescita Investment Management Private Limited. Please go ahead.
- Dhruv Agarwal:** Sir we will not be having any tax payables for this right?
- Sachit Jain:** Yes, we are only paying MAT, which has been put in the balance sheet.
- Dhruv Agarwal:** Okay. Next year I guess it would be around 18% to 20% tax for us.
- Sachit Jain:** Next year we will start paying tax.
- Dhruv Agarwal:** Okay so that would be 18% to 20% or if you can give any percentage what would it be?
- Sachit Jain:** Current tax will start accruing from the second half so on an average for full year it will be 17% to 18% yes.
- Dhruv Agarwal:** 17% to 18% okay Sir, thank you so much.
- Moderator:** Thank you. The next question is from the line of Manish Saigal, Retail Investor. Please go ahead.
- Manish Saigal:** Just wanted to quickly understand from Sir is there any plans to make sure that our return on capital employed goes into mid teens?
- Sachit Jain:** Yes we are committed to improving the EBITDA to capital employed to 18% in the next three years; however, these three years may move to four because of the increased price of raw material and inventory and because of massive increase in prices, so the capital locked up and working capital has gone up beyond our calculations. So with that it may take one more year but our target will be that in three years' time to hit the figure of 18%.
- Manish Saigal:** Once we take into account the incentives what would be the number on the net profit, if we had taken that into account?
- Sachit Jain:** We are sure we will cross 18%.
- Manish Saigal:** For this quarter, we have not taken it into account had we done that?

Sachit Jain: See there are two different incentives we are talking about. First is for the what I spoke earlier in my comments was about the ongoing expansion, which is currently going on and that is going to get covered in the new incentive policy, which will kick in sometime next year after this expansion if the first case is completed. Okay, so it will kick in sometime first half of next year probably. That is one incentive that we talked about. The second is the incentive that we are talking over the last five years because there in our balance sheet we keep mentioning about, which the earlier investment is already made. This has already been sanctioned, the incentives have been sanctioned but as I said reported earlier we have been discussing with government that the basis of the incentive calculation is not fair and needs to be readdressed. Our concerns have been taken account in the announcement of the new policy and by all indications, we should get part of that addressed in the older policy also is the indication we have got from government people. So they said let the new policy get announced and then we will go back to the old policy. So in the next three to six months we should get the clarity out there. Otherwise, it is expected to be Rs.2.5 to Rs.3 Crores a year. If what we expect does not happen, then it will be Rs.2.5 to Rs.3 Crores a year and we have pending backlog of two years. So this year we will get three years worth of incentives so at least 9 to 10 Crores we should get second half of this year.

Manish Saigal: So which we will account perhaps in the yearly results?

Sachit Jain: Yes that will come in the second half unless if decide to wait a little longer, but that is accruing.

Manish Saigal: Sure. Thanks.

Sachit Jain: Our hope is to get more than that.

Manish Saigal: Of course.

Moderator: Thank you. As there are no further questions, I now hand the conference over to the management for their closing comments.

Sachit Jain: Ladies and gentleman thank you so much for being with us today. I believe there is a conference of September 3, 2018, and Sanjeev Singla, CFO, and Poorva from Investor Relations are going to be there in Mumbai, physically present, and as I said earlier sometime in the month of November we will be planning a physical meet hosted by the management. Thank you for being with us. All the best.

Moderator: Thank you. Ladies and gentlemen, on behalf of Edelweiss Broking Limited that concludes today's conference. Thank you for joining us. You may now disconnect your lines.