“Vardhman Special Steels Limited
Q2 FY2020 Earnings Conference Call”

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Moderator: Good day ladies and gentlemen and welcome to the Vardhman Special Steels Limited Q2 FY2020 Earnings Conference Call hosted by IIFL Institutional Equities. 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, please signal an operator by pressing "*" then "0" on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Urvil Bhatt from IIFL Institutional Equities. Thank you and over to you Sir!

Urvil Bhatt: Thanks, Hina. Good morning everyone. On behalf of IIFL Institutional Equities I welcome you all to the Q2 & H1 FY2020 Earnings Call with Vardhman Special Steels. We have Mr. Sachit Jain – Vice Chairman and Managing Director and Mr. Sanjeev Singla – Chief Financial Officer on this call. Without further delay, I handover the call to the management for opening comments post which we can have the Q&A session. Over to you Sir!

Sachit Jain: Good morning everyone and thank you for joining us in our earnings call for the second quarter and half year ended 30th September. Let me first of all apologize that we could not organize a call in the first quarter because of Aichi our partners not wanting to handle any questions or project declarations till a formal signing with their President which happened on 27th August and my apologize for that and joining us very shortly Sonam Taneja, our company secretary, will be joining us and of course Bridge IR our investor relations team are already on the call.

So the recent developments in the last six months has been of course we had a plant upgradation of our melting shop so we had a huge shutdown for 62 days partly in the first quarter, but largely the second quarter so that was done successfully, commercial production started from early September and it has been a reasonably smooth start at least that is what we have been told that the new furnace is functioning well and of course the most important event is the signing of the technical assistance agreement with Aichi Steel Corporation and the strategic stake sale of 11.46% by way of preferential issue of equity shares aggregating about Rs.50 Crores at a price of Rs.108 per equity share price. Mr. Ishigami has been appointment as a non-executive director as a representative of Aichi Steel Corporation, Ishigami san is the President of the Steel Division of Aichi Steel Corporation.

Very briefly, Aichi Steel Corporation started out as a steel division of Toyota and later got hived off as into a separate company. Even today it is largely seen as a steel supplier to Toyota Group. Aichi Steel Corporation has three divisions, steel division is one of those divisions, and Ishigami san is the President of Steel division. They have a forging division, they are I think the largest forging companies in the world, again largely for Toyota and they have a smart company, which deals with magnets and sensors and some other future businesses. So, our alliance is of course with the steel company. The technical assistance agreement started from first week of October. The fact-finding team is already in place for two weeks here, we had senior management also here, we had marketing people here. The help and support we are getting from Aichi is considerable and I am very, very hopeful of the positive impact of this in the future as many of you know, I have been pursuing Aichi Steel Corporation since last eight years to alliance with us and I am extremely happy that in this dull and dismal market scenario at this point they have agreed to come in as an investor and giving a technical assistance agreement.

So as far as the performance of this quarter and the numbers are concerned, I will ask Sanjeev Singla to go through the numbers and after that we will have the Q&A.

Sanjeev Singla: During the quarter there was a shutdown of our steel melt shop but we continued servicing our customers from the inventory which was build up for this period and the total sales happened during the quarter is 33203 tonnes which is 22% low as against the last year and the revenue from operations is 211.82 Crores, EBITDA is close to 8 Crores as against 16 Crores from the last year which is 51% decline mainly because the decline in volumes and prices and also some inventory loss because in the second quarter the prices of raw material have come down. Similarly, in the first half the total sales volume is close to 70000 tonnes of sales which is 17% decline from the corresponding last year first half and EBITDA is 24.01 Crores as against 36.17 Crores of last year, 33% decline mainly because of lower volume and higher inventory carrying cost in the current financial year. The net loss for the first half is 2.03 Crores as against 16.15 Crores of profit last year. One more thing that this quarter we have accounted for exemption from electricity duty from the State Government of Rs. 4.40 Crores which was long pending for the last two years so the same has been accounted for in the current quarter. That is all on the operations part.

Sachit Jain: Let me briefly share that the overall market condition seems to be pretty grim as you all are aware that we are primarily linked to the auto sector and auto sector is definitely struggling, the sales are down ranging from 25% to 35% in various segments so we have also got affected because of that. As of now of course there is a slight uptake in October sales, whether this will remain we are not aware of that. Really for us the positive things we are looking at is one when the auto sector moves up and two when stabilization with Aichi and they are helping us move into new markets and new customers which would happen sometime in the next financial year. Those are the two positives we are looking at. Very clearly they are helping us, they are identifying scope for cost reduction so over the next few months we will see some work in those areas also. The other positive view seems to be that there are indications that on the environment area there would be some relaxation so we had applied again for our expansion and let us see how that application goes through. So that is all from our side. We are ready for questions.

Moderator: Thank you very much Sir. Ladies and gentlemen. we will now begin the question and answer session. The first question is from the line of Ratish Varier from Sundaram Mutual Funds. Please go ahead.

Ratish Varier: Good morning Sir and congrats on the tie-up.

Sachit Jain: Thank you, something good to look at.

Ratish Varier: I just wanted to ask you on the operational front any thought process on what have been volume number we could do in the second half and second is the raw material benefit will anything flow through for us in the second half because if you look at your EBITDA per ton it is actually one of the lowest ever right if I am not wrong in terms of your EBITDA per ton number.

Sachit Jain: Second quarter any figure does not make any sense to compare because the furnace was operated for a few days so the production is very low whereas all the workers were there so those costs have been, a fixed cost was there, plus in the starter part the power consumptions were way higher so all were way higher than normal.

So all those are stabilizing now, second quarter numbers I think are absolutely uncomparable.

Ratish Varier: Second half any thought process on where we could see our volumes?

Sachit Jain: Volume the way we see it we believe, the way things stand now, it could be around 10000 ton per month.

Ratish Varier: That is what the number you have seen in the month of October?

Sachit Jain: Yes that's the number you see in October, 10000, between 9.5 to 10, that is what we see as of now and third quarter with all the benefits of raw material, low raw material prices, but also tight negotiations are currently going on so we do not know at what level the prices will settle. Even auto companies are hurting we do not know the levels of the prices that will settle at. There would be some inventory devaluation because of the fallen prices. The fourth quarter should be better than the third quarter because the inventory pass through all would have happen and there will no further devaluation done.

Ratish Varier: Okay. Sir, in terms of our EBITDA per ton any guidance in terms of where it could settle in the second half because as you said the second quarter was a big aberration?

Sachit Jain: It is difficult to say because still the prices settle see up till now we were reasonably confident of where the EBITDAs would move but the way other companies had been behaving in terms of not looking at cost and abruptly setting prices because they are hurting very badly so suddenly the game has changed from March this year, the financial last year when many of the auto companies the price settlement had nothing linked to the cost.

Ratish Varier: Because if you go back to 2015 kind of levels do you see we reaching that kind of numbers?

Sachit Jain: We should definitely do better than those levels it would not be as bad as that and as I shared with you the benefits of the partnership should start picking in next financial year so difficult to say exactly when, but I have seen the power of the clouds they have and in the last couple of meetings that we had with various customers the kind of positivity we are getting from customers is phenomenon. So how it will translate into business immediately or within a few months that is difficult to say but I am extremely hopeful of the future of our company despite the current slow down and of course if the Indian market improve we have definitely very positive situation.

Ratish Varier: Sir just one last question from my side. You talked about the association helping you to go towards export market where they are introducing you outside. Can you throw little more light on that please?

Sachit Jain: The main markets for us, India has been our main market and we are a little exporting to South East Asia because steel has become difficult to transport too much so South East Asia is biggest market and this is an area still dominated by Japanese auto companies again, huge concentration of Japanese auto companies and Japanese auto companies are highly familiar with the Japanese steel maker like Aichi Steel companies and they have their own operations. So as our quality improves towards Japanese standards or close to them as it becomes comparative over the next few months, they clearly will get us these opportunities.

Ratish Varier: You said that you asked for again an environmental clearance so what is the additions now we are looking at in our capacity?

Sachit Jain: We have said that we would like to target on a 240000 tons of capacity, melting capacity which clamped down by the government in November last year who suddenly said that no environment clearance will happen and now there is a new order of NGT which has come, which says that on case to case basis if the environment norms are being met, etc. approvals can be given. This NGT order came in August we are hopeful again and therefore we have applied after that. So our application has been received and being considered. Still fingers crossed, but at least we are hopeful now that the approval for expansion would come in.

Ratish Varier: So the melting shaft capacity will increase to 240000….

Sachit Jain: As of now it is restricted to 200,000 tons.

Ratish Varier: Yes, thanks.

Sachit Jain: We hope we are applying for 280000 tons of melting capacity.

Ratish Varier: Along with the same approval?

Sachit Jain: Yes, the approval we have asked for 280000 tons because we also believe 240 something that we could see with the Japanese coming in we hope that they will be able to help improve productivity to go beyond 240, but as of now the plan that we can visualize is 240000 tons but we have applied for 280000 tons.

Ratish Varier: Okay. That's it from side.

Sachit Jain: Let me make one more statement for Aichi Steel purpose one of their biggest concern about us was very small capacity so in fact they are equally concerned about us that if this approval comes through because the amount of material they believe together we can sell in India and in South East Asia grossly exceeds this amount so this is something which is very high on their agenda and also my personal agenda this is one of my biggest area of my effort.

Moderator: Thank you very much. The next question is from the line of Urvil Bhatt from IIFL Institutional Equities. Please go ahead.

Urvil Bhatt: Congratulations for Aichi tie-up so just wanted to understand you mentioned that you guys would be targeting the export market especially in South East Asia just wanted to understand what all approvals or other modifications to our plant or any other approvals will be required to achieve these levels. Also what is the road map over the next few quarters as to how exactly we plan to start exporting to South East Asia using Aichi as our partner?

Sachit Jain: It is too premature to make any detail plans now because currently we are in a fact-finding study and from February we will start working with an action plan so I guess in the annual meet we will have, we will have a much clearer agenda our road map.

Urvil Bhatt: Okay and what was the Capex incurred in Q2 and what is the guidance for second half and maybe FY2020 that you will get back into expand capacity when you get the approval, just wanted to understand our Capex?

Sachit Jain: We have put all further uncommitted Capex on hold because now that we have an equity investment for Aichi, all Capex will be jointly planned together so we have put everything on hold. Mr. Singla how much have we invested in Q2?

Sanjeev Singla: In Q2 we have capitalised more than 55 Crores of rupees that have been completed in Q2.

Urvil Bhatt: Okay and what we are targeting for second half and…

Sachit Jain: I said we have put all further Capex on hold and there is some just pending Capex which is already ongoing which is about Rs.5 to 7 Crores. All other Capex plans have been put on hold, new plan will be made and announced after it is discussed with Aichi.

Urvil Bhatt: Perfect and one more just bookkeeping question. Just wanted to understand the inventory impact that we faced in Q2 and are we done with that or we will still see some inventory related headwinds in Q3?

Sachit Jain: Q3 also there will be some inventory devaluation because the prices of raw material have been falling continuously also electrodes have been falling so these are two main reasons because of which there will be further inventory devaluation.

Urvil Bhatt: Okay. That's all from my side.

Sachit Jain: But the large part of the inventory which was built up for the shutdown has been largely eaten away. Debt figures have fallen from Rs.340 Crores to around Rs.290 Crores and coming down every month. In addition, 50 Crores that has come from Aichi is being passed in an FD which came in on 1st of November so that is already in and that is the near mark for specific Capex as again discussed along with Aichi. So the balance sheet of the company has become much stronger than what it was.

Urvil Bhatt: Great. Thanks.

Moderator: Thank you. We will take the next question from the line of Devang Sanghvi from ICICI Securities. Please go ahead.

Devang Sanghvi: Sir, first of all congrats on the Aichi collaboration. My question is regarding the raw material prices trend. Do we expect some amount of lower cost in H2 considering the scrap prices movement?

Sachit Jain: The cost definitely will be lower but the raw material seems to have bottomed out. So we had seen that after bottoming out, raw material prices have increased slightly it is seems bottoming out is over.

Devang Sanghvi: This is for scrap or graphite electrodes, which one we are talking about over here?

Sachit Jain: Scrap. Graphite electrodes also I think has bottomed out.

Devang Sanghvi: So that also has bottomed out.

Sachit Jain: In our opinion, prices have been fluctuating we have been proven wrong. The last two years these prices have been fluctuating so widely so we are not able to predict that. As of now it looks like bottoming out is happening.

Devang Sanghvi: Okay Sir. Secondly, as we are indicated October, November did see some uptake for auto sector of course it is very difficult to predict the moment but then do we see an increased ordering from the auto giant OEM at the moment?

Sachit Jain: Not at the moment. That what we are hearing is Maruti is increasing its production to second shift has started in one of the plants so may be we have some good news, but as of now no positive news which has filtered through us.

Devang Sanghvi: Any comment on the working capital cycle, do we see some improvement after the H1?

Sachit Jain: Our inventories that have been built up has largely been used away of course you are not able to have exact stocks because we had so many products that we make so matching each product to the inventory required has not been up to the mark, I mean there have been some gap. So there is some surplus inventory on some grade which will get used up in the next three to six months. Inventory and working capital cycle has now reached near normal level.

Devang Sanghvi: Since we have hold the Capex at the moment so we do expect the debt levels to go down going forward?

Sachit Jain: Net debt level has definitely come down and 50 Crores coming in and that goes on significantly. When I say Capex is on hold, is only for one reason that we want to take the expertise of Aichi on board. Once joint plans are made we do foresee investments of between Rs. 50 to 70 Crores in the coming couple of years that exact plans and amounts will be finalized in the next six months.

Devang Sanghvi: On the product innovation with Aichi that will broadly come next year, my understanding is correct?

Sachit Jain: It will take time, see, there are two parts of product innovation one is improvement in the existing products and then second will be products which they have, patented products that they have, which could come in the country depending on the customer need and third would be product jointly done by us. So product jointly done by us will take much longer, improvement on existing products we should start think to get some gains in that in the next financial year and their patent product coming to the country may be the year after that so it is a series of improvement which will happen all depends on customer. It is very clear that there is a localization push in the customer so there is still large amount of special steel for example Maruti Suzuki they import it from Japan. There is a clear intent and they try to reduce the quantity of export and localize that. So those are the kind of products that we will be targeting.

Devang Sanghvi: Just one bookkeeping question what would be the bright bar volumes for the quarter out of the 33000?

Sanjeev Singla: Nearly 7200 tons.

Devang Sanghvi: What is the compatible number for Q1 and last year Q2?

Sanjeev Singla: Q1 was 7300 and corresponding last full year was 31000 tons.

Devang Sanghvi: Q2 FY2019 I was asking, the compatible last year number?

Sachit Jain: The drop is much lower in bright bar than the remaining other business.

Sanjeev Singla: Right now I do not have it.

Devang Sanghvi: No problem I will get back on that. Thanks a lot Sir, all the best.

Moderator: Thank you very much. Our next question is from the line of Rohan Mehta an individual investor. Please go ahead.

Rohan Mehta: Good morning Sir. First of all congratulations on the tie up with Aichi Steel Just wanted to ask what areas specifically will the joint venture focus on in the near future and by when do we expect the synergies from this tie up to pan out with respect to our performance?

Sachit Jain: First of all it is not joint venture it is a strategic investment, it is actually issuance of equity so they are not part of our management, they are minority investor and they have been given both minority protection rights. The focus is technical assistance agreement with them where they are going to help us upgrade our products and reduce our cost, so benefits are going to keep coming in. For example, their ways of working have already started affecting our people's ways of working. The ability to solve problems, the ability to look at data, all that is changing, and we are able to get their experts, we are able to see areas of improvement so that process has already begun. It will pick up momentum in next year because over the next two to three months we will be formulating full KPI of what are the scope of improvement that they see along with our people. So the real benefit will start coming in either way I see the second half of next financial year, we could start seeing the benefits coming in. Some benefits will start coming in earlier but really I would say second half of next year.

Rohan Mehta: Okay. Sir given the current market condition of the auto sector the way it had been just wanted to get some light and your opinion on when you expect to turn around and signs of recovery going forward and how would our company's full year performance look, any guidance on that if you could give?

Sachit Jain: I am extremely optimistic so I am looking on this as a very good opportunity to look inwards look at renewal look at cost that were not seen earlier, some harsher decisions have to be taken, some more focus has to happen so I would look at this as a good time because the way things are going last year where there was absolutely mad scramble for material and we were not able to supply our customers those lead to the system get affected. So this is an area and time for us to improve our systems, SOPs all those things but as to when would things start improving really I have no way of answering that, but I am extremely positive, the way the Government is beginning to look at solutions we should see improvement maybe two quarters down the line, but I am warning you first of all I am optimistic but I would say things should start improving from the beginning of the next financial year.

Rohan Mehta: Okay. Thanks a lot Sir and all the best.

Moderator: Thank you very much. Our next question is from the line of Mehul Mehta an individual investor. Please go ahead.

Mehul Mehta: Sir my first question is Government of India is coming up with scrappage policy, how does it impact the auto market. This is my first question. The second question the news which has come last time which I read that Maruti and Toyota tie-up in a scrappage plant so how will that impact the supply of raw material for the steel industry?

Sachit Jain: See the scrappage policy has been biggest demand of the alloy steel industry and I would say the rest of the steel industry also. So this is a huge game changer and this is going to have triple benefits, one scrapping old vehicles means pollution gets affected, here we are going to BS6 and we have highly polluting vehicles on the road and that is one big thing for environment. Secondly it removes old vehicle and therefore creates demand for new vehicle and third it will definitely enable more scrap availability for people like us. So I am very optimistic with the scrappage policy coming in and with some shredding plants now beginning to come up, over the next year or so things are going to become much more positive for companies like us. This is the way it is there in every country in the world. I am very optimistic.

Mehul Mehta: Okay. Good. Thank you sir.

Sachit Jain: But it will take a year or so I mean please do not expect any immediate impact because shredding plants are coming up where we do not have that kind of. As more shredding plants come up then the availability of raw material will improve, but demand cost will definitely go up the moment the scraping starts.

Mehul Mehta: Do we have any strategy plan for the scrappage policy?

Sachit Jain: No we do not have any strategy because when it happens automatically demand will go up and we will be ready to take advantage of the demand. We do not believe in laying off people, see many companies remove people when down turn happens. So Vardhman group does not believe in this policy, people are our assets and we have held on to our people. The moment there is a demand we will be ready to handle any demand that comes we will be ready handle when it comes. We have a long-term policy, we look people as assets and not as cost.

Mehul Mehta: Okay Sir. Thank you so much.

Moderator: Thank you. Ladies and gentleman that was the last question. I would now like to hand the floor back to the management for closing comments. Over to you Sir!

Sachit Jain: Thank you so much. Ladies and gentleman thank you so much for showing interest in our company. I am not very happy with the performance that we have shown this first half, second half is also looking tough as of now, but I hope the next year we should be able to win back the confidence in the next financial year and thank you so much.

Somebody asked the question Q2 last year was 7600 tons Q2 of last year bright bars. If the person is still on the call the answer is 7600 tons of bright bars last year. Thank you.

Moderator: Thank you members of the management. Ladies and gentlemen, on behalf of IIFL Institutional Equities that concludes this conference. Thank you for joining us. You may now disconnect your lines.