



“Vardhman Special Steels Limited
Q3 FY2020 Earnings Conference Call”

February 11, 2020



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Moderator: Ladies and gentlemen, welcome to the Q3 FY2020 results Call of Vardhman Special Steels Limited hosted by Emkay Global Financial Services. We have with us today, Mr. Sachit Jain, Vice Chairman & Managing Director and Mr. Sanjeev Singla, Chief Financial Officer.

This conference may contain forward-looking statement about the company, which are based on beliefs, opinions and expectation of the company as on date of this call. The statements are not guaranteed of future performance and involve risks and uncertainties that are difficult to predict.

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. Kamal Kant Sahoo from Emkay Global Financial Services. Thank you and over to you Sir!

Kamal Kant Sahoo: Good afternoon everyone. I would like to welcome the management and thank them for giving us this opportunity. I would like to hand over the call to the management for the opening remarks. Over to you gentlemen!

Sachit Jain: Good afternoon everybody and thank you for coming to our call. I would like to put 2019 as Annus Horribilis. It has been a very tough year and third quarter of course we are seeing the worst period is over. If it was not for the tax write back, there would have been a loss but with the deferred tax changes because of the impending reduction of income tax at appropriate time, when we will do that there was a reversal in the deferred tax rates and therefore there is a write back on that account. So at least we are not in the red, we are back in the black.

As we move ahead, we will look forward to the positive which is bad time. I think this tough time has given us a lot of opportunity to look inside us because markets were down and therefore volumes were down and of course cost had gone up significantly, manpower cost for example had gone up by Rs.1000 tonne just because of drop in volume. You will lose profitability because of extra margin as well as other products that we had done because labour is not really a variable cost, it is a semi fixed cost. So also power, so also oil many of them are semi fixed cost, refractory is semi fixed cost. So all these cost per tonne go up at a lower volume level.



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Other positives are of course, the progress with Aichi has begun, from October we have started working with them. Money from Aichi has come in. They have become share holders. Mr. Takashi Ishigami has become the Non-Executive Director as representative of Aichi. We also had other income some government incentives in the second quarter had come 4.41 Crores direct from the second quarter part for nine months' results.

The other part that I want to share with you is, how is the impact of Aichi? One, very clearly we are seeing change in the culture of our people as they are seeing the much more systematic approach from the Japanese. Data orientation becomes much stronger and with the skills becoming stronger, ability to solve problems, the confidence that we have a big partner by aside all that changing. These are the changes I am personally seeing.

The second change we are seeing is in terms of the access to customers and markets. The senior level executives are able to be accessed because all the OEMs, the customers are mostly Japanese or Japanese oriented whether it is Maruti Suzuki, whether it is Toyota, so these are the two main customers we have targeted so far and some other Tier 1 we're supplying to Honda and the others.

We are seeing the change in there and the way they look at us and the access we are able to have at far senior levels than what we were able to get earlier on our own. So clearly that change is happening.

Now as I said from February onwards, they have now come in and now they are here to stay. The big picture that they have the vision that we are working out together is to produce Japanese quality steel in India at competitive rates to fight in the Asean market as well as the Indian market. So, the vision is to become a big support to Toyota group from a base outside of Japan. Of course, Toyota comes in as well as other Japanese OEMs that we will try with service in India as well as outside.

On the first phase will be to reduce our costs and improve our quality. Projects have been formed, project teams have been formed and they are working on all those areas. Some results initial results, some problems have already begun to come in but really more the results will come in later.

As we improve our systems, new products will also come into the company as and when they feel we are ready. Overall, I am very enthused with this relationship is going in the right direction.

On our own, we have also looked at our own systems, our own areas of cost saving, we have found areas that we had perhaps not looked at earlier, so we have found areas to improve our competitiveness, you will see the impact of that coming in from fourth quarter and then in the next quarter so on.



We expect the worst is behind. Fourth quarter performance should be better but real improvement should happen when the price increase will happen from April as you are aware, commodities steels have gone up by Rs.5,000 to Rs.7,000 a tonne. So we do expect that we will also get some price increase in April. After that I do expect next year to be significantly better.

The concern that we have for next year is still the BS6 coming in, the prices of auto is going to be high, so the first quarter we do not know how sales will pickup but the feeling as we talked to our customers is really second quarter on but things should be better as far as sale pickup is concerned and the other uncertainty of course is with the Coronavirus which might affect supply change from China, many of the OEMs do not know at which level Tier 2, Tier 3, Tier 4 some parts may be coming from China which may have an impact. So we are not aware of that as of now but otherwise the worst is behind and the other factor which has led to poorer performance in the third quarter is because of the prices of raw material came down as well as graphite electrodes came down, so there was inventory devaluation and since we had a huge amount of inventory, on account of our shut down as well as some stock that were left, a billet stock and rolled products stock, it has still got left which are getting consumed slowly. So we had very large disproportionate inventory right down.

Fourth quarter we are finding that raw material prices are gone up again sharply in fact prices went up at Rs.3000 a tonne in the matter of course of one and a half months. That has yet to apprise to a cost push in the fourth quarter but the cost saving that we have found out we have been able to work on internally will ensure that looks like at this point in time that we may not be in the red in the fourth quarter and of course of the tax write back, three quarter was done in the third quarter and one fourth of it will be done in the fourth quarter. This is all I have to say at this point in time. We are open for questions.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Manish Saigal, he is a retail investor. Please go ahead.

Manish Saigal: Good afternoon Sir. Just wanted to check what is the kind of volume we are expecting in Q4 as also what kind of price hike do we see coming through starting Q1 next year?

Sachit Jain: Volume could be difficult to say about 32,000 to 33,000 tonnes around that figure, maybe marginally higher than third quarter.

Manish Saigal: Okay and the price hike?

Sachit Jain: Price hike, we are hope for Rs. 4,000 to Rs. 5,000 a tonne but we do not know what we will get. It will be due from April 1st not from fourth quarter. I am repeating, we do not know what would be the extent of the price hike.



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- Manish Saigal:** Understood. This is just a ballpark I wanted to understand. Another thing was that you had applied for environmental clearance for the expanded capacity, any developments there?
- Sachit Jain:** Yes, in fact I think there are some positive developments on that front. One, I think the NGT clarified to the MoEF that for companies that are within the norms there is no intention to disrupt industrial production I mean I do not have the exact wording of the order but august this order came in and after that we have got the terms of reference from the MoEF which means I think these things are progressing well, looks like we have hope to get the approval by the end of this year, we should be able to get the approval but things are looking far more positive on this front than what they were during our last concall.
- Manish Saigal:** Okay. So you said we will be selling 32,000 to 33,000 tonnes, what is the kind of capacity we have if there was demand?
- Sachit Jain:** If the demand, we should be selling about 45,000 tonnes a month.
- Manish Saigal:** Okay, long way to go there.
- Sachit Jain:** Sorry, quarter.
- Manish Saigal:** Yes which means the long way to go still we are running at about 60% to 65%?
- Sachit Jain:** Yes, about 65%.
- Manish Saigal:** I know the market is very uncertain, any line up side of when we will be able to pull this capacity?
- Sachit Jain:** Sorry, we have about 75% utilisation, not 65%.
- Manish Saigal:** When we would be able to fill the capacity fully if you have some sense, I know market is uncertain but still you would have some?
- Sachit Jain:** If the OEMs themselves are not able to commit, how can we have an idea.
- Manish Saigal:** Right. I mean still we are trying diversify the product base?
- Sachit Jain:** The diversification is going to happen is only to the Asean markets through Aichi. That process is going to begin where they will be taking us to the Asean customers and all that process is going to begin from March. It is at least one year out.
- Manish Saigal:** Thank you so much.
- Moderator:** Thank you. The next question is from the line of Rikesh Parikh from Barclays. Please go ahead.
- Rikesh Parikh:** Thanks for the opportunity. Sir, can you just throw some light on what are the debt levels right now?



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- Sachit Jain:** Right now the total debt as on December 31, 2019, it was 260 Crores.
- Rikesh Parikh:** About inventory days?
- Sachit Jain:** Total inventory finished goods we are carrying about 40 days to 45 days.
- Rikesh Parikh:** Broadly the build up what yet carried at the time of so we have now will be able to reduce?
- Sachit Jain:** Yes, significantly reduced though still some of the billets that we have, see this 45 days includes billets as well as rolled products. Billets we count as finished good otherwise billets are really our intermediary good they are semi because we will be rolling them. We do not sell billets outside but when we had the shutdown, we built up stock, those stocks are built up on the basis of estimates and because the markets were down and sale change, so some products have got leftover which should take another three to four months, by March we should be down to normal level.
- Rikesh Parikh:** Can you just throw some light and Sir what kind of market improvement your interaction with the manufacturers, so what kind of scenario we are seeing the down line as such?
- Sachit Jain:** No one is able to tell anything. The best people to answer this question is the OEMs themselves but we are seeing a slight pull which has come in, in the fourth quarter and whether it will sustain or not we do not know but most people are saying that really it is the Diwali season when things will pick up. Most people definitely seem to see that the worst is really behind us. That seems to be the concern when I talk to people.
- Let me tell you one thing for the next financial year, in our forecast, we are not taking any improvements from the market but we are taking improvements in our results. So we are very clearly because of the internal improvements we have had we feel that next year even if there is no change in the market, we will be much better off than where we are today and the results that we have shown is third quarter, have been after providing for Aichi Steel. This is the new element has come in, so we have been providing fully for all the fee to Aichi Steel. The benefit of Aichi will come later but the fees are coming in from October onwards.
- Rikesh Parikh:** Okay and any improvement or basically, you broadly touch up on the improvement looking into the product diversification improvement from the Aichi side, any material thing we can foresee over next one year or so?
- Sachit Jain:** No.
- Rikesh Parikh:** Nothing on the immediate future. Thank you. That is it from my side.
- Moderator:** Thank you. The next question is from the line of Abhijeet Vara from Sundaram Mutual Fund. Please go ahead.



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- Abhijeet Vara:** Thanks for taking my question. Sir first question is what is the installed capacity as of now?
- Sachit Jain:** Installed capacity is 180,000 tonnes of roll products. I mean it is 2,00,000 tonnes of billets as well as 2 lakhs tonnes of roll product but with billets of 2 lakhs tonnes, we can do 180,000 tonnes of rolled product.
- Abhijeet Vara:** Okay. So billet is the bottleneck as of now?
- Sachit Jain:** No the environment constraint is the bottleneck and yes so the billet is a bottle neck correct but as of now the margin is the bottleneck.
- Abhijeet Vara:** Sure. Can you please explain this Aichi fees, what is the fees, is it percentage of revenue?
- Sachit Jain:** No we are not disclosing the fees but I think the entire fee, the fees has two components, one component is the fees we are paying to them half yearly as technical fee and second fees is the fees for the technical people who are deployed here or will come on short-term basis as and when required. Let us say is a reasonable fees I can say that.
- Abhijeet Vara:** Just on the balance sheet Sir. You have mentioned the gross debt number but what is the net debt number and also in your expectations let us say when will the debt peak out because on the basis of debt do we expect the debt to increase from here on?
- Sachit Jain:** The net debt should be about 210 Crores roughly. There is 50 Crores FD, the Aichi money is reported to fixed deposit. That is meant for specific capex as and when Aichi and Vardhaman together approve that capex, so that money is meant for that capex. So the balance sheet is in a healthy position I can say that.
- Abhijeet Vara:** Do you expect the debt to increase from here on?
- Sanjeev Singla:** Debt to equity is 0.6.
- Sachit Jain:** Unlikely to increase.
- Abhijeet Vara:** Okay. Despite the volumes being down and OEMs numbers is not same, any improvement during market, your working capital is not deteriorating right, just to clarify?
- Sachit Jain:** We had very high working capital because of the buildup of stock which has got gradually, largely brought down. Some still remains, so there will be further improvement in the working capital by March.
- Abhijeet Vara:** Those were my questions. Thank you. I will get back in the queue.
- Moderator:** Thank you. The next question is Rohan Mehta, he is an individual investor. Please go ahead.



- Rohan Mehta:** Good afternoon Sir. Just couple of questions around Aichi the 50 Crores that you mentioned which are in FD right now, when and how do we plan to utilise that?
- Sachit Jain:** Those plans have been formulated with Aichi and as and when those plans get okay will draw the money from this.
- Rohan Mehta:** Okay, so now particular focus area that have been narrow down right now where we will be utilizing our fund?
- Sachit Jain:** Focussed area is for quality improvement and cost reduction. Those are the two focus areas. They may have on their agenda but they will be discussing with us shortly and those plans will be made.
- Rohan Mehta:** So to build on what you explain about how do the synergies are coming along with Aichi, when roughly can we expect these positive effects to reflect on our books as well on a financial front?
- Sachit Jain:** The cost saving that we have been able to bring about is very difficult to say that only we have brought about or some of there have been triggered by their coming in. So the impact of that we will see partly in fourth quarter and largely in the first quarter of next year. These are what our people have brought about but have they have been influenced because of Aichi's thinking or not difficult to set that aside but I can say that the team has done a good job to find out areas improvement that in the fourth quarter despite a hefty increase on raw material prices, we are expecting to be out of the red zone. This is despite hefty increase a lot of impact.
- Rohan Mehta:** Right and Sir if you could just shed some light on what we are expecting what kind of EBITDA level for EBITDA margins for this whole year?
- Sachit Jain:** This year is just about barely breakeven or a net loss level little marginal profit, we are in that zone. So this year I would say Annus Horribilis I call that the beginning.
- Rohan Mehta:** By Q4 improvement should begin?
- Sachit Jain:** Next year definitely we should be back on that track.
- Rohan Mehta:** That was all from my side. All the best. Thank you.
- Moderator:** Thank you. The next question is from the line of Manish Saigal, he is a retailer investor. Please go ahead.
- Manish Saigal:** One question I forgot asking was impact of potential scrappage policy on business as a whole starting from raw material cost to an eventual product?



- Sachit Jain:** I think this is a very, very positive move from the government. This can be a potential game changer. It will have three impacts two directly on our business. One is with the scrappage of vehicles coming in it is clearly old vehicles gets scrapped, there is demand for new vehicle. So that is one positive.
- Two, since we are based on scrap, these old vehicles when they get scrapped with the new shredders coming up, we will get shredded steel available domestically which should be at a lower price than what is available for imports. So we should see a reduction in our raw material cost. We see a double benefit based of the scrappage policy and this is the norm world over and it will be better for the environment.
- Manish Saigal:** Do we see structurally our EBITDA levels increasing going forward from whatever we used to have from 5000 to 6000 a tonne to slightly higher because of this?
- Sachit Jain:** We were not at 6000 but we were about 5000 to 5200 levels I mean we were targeting 6 but we never reach there. Yes I think we can see those figures if this happens but it will take a year or so for the full impact to come in because still enough shredding capacity has not come up in the country, it is coming up being set up but not enough has happened so far but moment the scrappage policy gets announced then this will happen.
- Manish Saigal:** Do you realistically see us going to 8000 a tonne EBITDA anytime after the call this is in a stable state?
- Sachit Jain:** It is difficult for me to say. It is too high to forecast just now but three years to four years from now I can see that possibility because once the capacity increase happens that is when the real impact on EBITDA will happen but we have not calculated that far. On the current capacity levels there are 200,000 a tonnes, Rs. 8,000 a tonne is unlikely.
- Manish Saigal:** Thank you.
- Moderator:** Thank you. As there are no further questions, I would now like to hand the conference over to the management for closing comments.



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Sachit Jain:

I would like to thank everyone for being on the call. We had a very tough year but as I said this tough year has thought us a few lessons and opportunities to improve and of course the big thing opportunity for us is Aichi as a partner going ahead. I would say one or two years more for to really starts seeing the benefits of Aichi but our own improvements should show the next year we are looking at a much better performance next year. All the best. Thank you so much.

Moderator:

Thank you. On behalf of Emkay Global Financial Services that concludes this conference. Thank you all for joining us and you may now disconnect your lines.