Rallis India Limited

Q2-FY20 Earnings Conference Call Transcript
October 23, 2019

Moderator: Good morning, ladies and gentlemen. Welcome to the Rallis India Limited Q2 FY20 Earnings Conference Call.. Please note that this conference is being recorded. I now hand the conference over to Mr. Gavin Desa of CDR India. Thank you and over to you, sir.

Gavin Desa: Thank you. Good day everyone and thank you for joining us on Rallis India Limited's Q2 FY20 Earnings Call. We have with us today Mr. Sanjiv Lal -- Managing Director and CEO, Mr. Nagarajan – Chief Operating Officer and Mr. Ashish Mehta – Chief Financial Officer.

Before we begin, I would like to mention that some of the statements made in today's discussions maybe forward looking in nature and may involve risks and uncertainties. A detailed statement in this regard is available in the results presentation. I now invite Mr. Lal to begin proceedings of the call. Over to you.

Sanjiv Lal: Thanks, Gavin and thank you all for joining our quarterly call. I have with me Mr. Nagarajan – our Chief Operating Officer and Ashish Mehta – our CFO. I will begin the discussion by highlighting the key operational and sector related developments. Post which, I will request Ashish to run you through the financial performance.

For the first half ending, we have delivered a topline and profitability growth of 12% and 5.4% respectively. The growth was largely export driven which grew by about 23%. Domestic markets performance was largely in line with the way the weather and the monsoon developed and panned out across the country. However, with the monsoons picking up late in the season and our new product launches and trade terms, we believe we are well placed to drive the growth going forward.

Talking about the industry level developments first, as most of you must be aware that we have had a significant variation in monsoon pattern during the year. The monsoon has started a bit late compared to the usual time, picked up significant momentum with flood-like situation in a few of the states. Such swing in the weather resulted in farmers opting to shift their focus towards short-duration crops. Also, lower pest infestation incidence occurred during the period. However, with better rainfall leading to improve water levels in the major reservoirs and good soil moisture levels, we expect Rabi season to be a much better this year.

Moving onto the company's specific developments starting with the domestic business, we believe that our performance during the first half of the year to be satisfactory especially if one takes into account the challenging backdrop. Nonetheless, we have made good progress in our stated strategy of driving growth. As indicated earlier, we are working towards strengthening our product portfolio with major focus on introducing new products. As most of you would remember, we had indicated that we would be launching 5 new products during this fiscal. We have already launched 4 products in Kharif including 2 co-marketing products. While it is a bit early to comment on the success, our new launches have been well received by the trade and farmers.

Moving onto our seeds business, we have historically had a very strong presence in paddy and millet crops. The delayed onset of monsoon resulted in crop shift in favor of short-duration millet and paddy which benefited the business. Further, our new launched millet hybrids have gained significant traction in the market. In addition, while maintaining our hold in the Kharif crops, our efforts are now directed towards strengthening our Rabi portfolio as well. We are focusing on fruits and vegetables, hybrid maize to make the overall seeds portfolio more balanced. This will obviously take some time to fully play out, but we will help us significantly going forward.

The capacity expansion of the first phase of Metribuzin capacity which was around 500 tonnes per annum has been completed and the plant has been commissioned and production started. The second phase comprising an additional 500 tonnes per annum is progressing as per schedule and should be completed and operational by December end. Overall, Metribuzin capacity will increase to about 2,000 tonnes per annum once we are through with the CAPEX. Revenues from the project should start fully reflecting in the financials from next financial year onwards. On Pendimethalin which is another big product for us, we have experienced over- supply in the market and expect some softness over the next quarter. Further, our CAPEX plan for expanding formulation capacity at Dahej chemical zone is well underway and we expected to be operational by next Kharif season.

Lastly, we are undertaking steps towards increasing our touch points, widening our dealer network. Our trade terms with our distributor partners has been well received and we will see it further strengthening during the current crop season.

Before I hand over to Ashish, I would just like to reiterate that we are undertaking requisite steps towards accelerating growth and consolidating our areas of strength. The CAPEX plan will not only help us address the product portfolio, but it will also help us become more integrated, reducing our dependence on sourcing key intermediates which has been one of the reason for lower margins in the overall category. Further, the revised credit terms also will help widen and cement our bonds with the dealers. Now, I will request Ashish to run us through the quarterly performance and we have already posted the results presentation which you would have all seen. So over to you, Ashish.

Ashish Mehta: Thank you and welcome all to this earnings call of Rallis Q2 FY20. While you must have gone through the numbers, I will quickly take you through the financials. Consolidated for Q2, we had a 14.5% increase in revenue, out of which almost 11% came through volume growth. Domestic business grew by 6%, out of which 4% was through volume and overall if you were to see the H1 performance, at a consolidated level, we grew by 12%, out of which 9% was through volume. EBITDA margins did see a pressure in Q2 as well.

We have been also discussing with you all in our various meetings that we have been witnessing pricing pressure largely because of the increased input cost and it has not been able to pass on the entire cost increase to the trade and this was reflected in the margins for the Q2 as well as H1 performance. PAT at consolidated level was at Rs.80 crore, down by about Rs.4.5 crore from the previous years.

The major highlight is on the cash generated from the operation which is at Rs.217 crore at a consolidated level, up from Rs.46 crore in the previous year. Working capital saw an improvement in terms of inventory days. It has improved quite a bit from 104 days to 85 days and we feel that our trade terms that we have announced in the market has been well accepted which has been reflected in the cash from operations. The CAPEX status has already been uploaded in the investors docket in terms of the expansion of the Metribuzin first phase and second phase. The work at the Dahej chemical zone is well underway and we expect the production to start in Q1 FY21. Thank you.

Moderator: Thank you. The first question is from the line of Aditya Jhawar from Investec. Please go ahead.

Aditya Jhawar: **Firstly,** thanks for increasing the disclosure levels. My first question is on gross margins. So we understand there could be some pressure on the raw material side, but it would be great if you can help us understand is there any change in the pricing strategy. For example, some of our key brands like Metribuzin, Pendimethalin, **,** earlier maybe there could be a process where our pricing would be at a premium versus competition. So has their pricing come, the premium come down or is there discounts now on certain molecules which was not there before on a YoY basis..

Sanjiv Lal: So Aditya, if we look at one of our export category products which is Pendimethalin, we have seen significant price drop in that and we have taken a price correction which has resulted in lower contribution margins. Likewise for domestic Metribuzin also, there has been price pressure because of increased price for one of the key raw materials that we used for Metribuzin. Largely, there are just 2 or 3 products where we have had some pressure on the raw material pricing which has resulted in lower contributions.

Aditya Jhawar: But there is no change in strategy, premium discount with regard to peers in the domestic market?

Sanjiv Lal: No, our brands continue to be the preferred brands in the market. Of course, there has been some price pressure on some of the brands. But considering the way the demand and the monsoon was playing out, we have not had any significant drop in any of our pricing to the trade.

Aditya Jhawar: And on the raw material side, what we were understanding that the incremental price increase or the quantum price increase that we were seeing has come down. So but looking at the gross margin which is almost at 7-year low, what sense are you guys getting in terms of some easing of this pressure on raw material side?

Sanjiv Lal: We are seeing some slight price correction at least in one of the raw materials that we are buying so that should help in Q3 and Q4. And at least for one of them which is the raw material for Metribuzin, we had already mentioned that we are looking at backward integration for which necessary CAPEX and all that has been already approved. So we will be going ahead with implementation of that in the next quarter.

Aditya Jhawar: So we could see some respite coming from next quarter because the Metribuzin raw material pricing….

Sanjiv Lal: I would not say next quarter, it will be perhaps in Q1 of next financial year.

Aditya Jhawar: And my final question is in this export ramp up is pretty encouraging, if you can break this up into branded exports and contract manufacturing export specifically for Metri and Pendi?

Sanjiv Lal: In fact, we have had some good demand coming in for both these products that we are exporting. While there may be some pricing pressure on the Pendimethalin, Metribuzin demand has been quite encouraging which is also being supported by us in terms of putting CAPEX on the ground. So both these are doing well and in the meantime, we are also getting some registrations for our formulated products also hopefully coming through sooner than later which will help us in the next year formulation sales as well.

Aditya Jhawar: So as of now it is B2B we are seeing good momentum and that is not necessarily in Rallis brand, right?

Sanjiv Lal: No, it will continue to be in B2B only.

Moderator: The next question is from the line of Prashant Biyani from Prabhudas Lilladher.

Prashant Biyani: Sir incrementally going into Q3 or H2, how do you see this raw material pricing panning out for us?

Sanjiv Lal: Prashant, as I mentioned, at least on one of the ingredients, we are seeing some price correction. So we should get that benefit in Q3 as well as Q4 and the other one which is for Metribuzin, so far there is no significant price drop that we are seeing, but we are working towards developing alternate suppliers also to see how we can get some advantage from lower costing.

Prashant Biyani: Do we also have some high cost inventory still with us on the raw material side?

Sanjiv Lal: As we had mentioned earlier that because of the various disruptions that potentially were happening in China, we have wanted to ensure that our assets are not getting compromised in terms of operations because of availability of raw material. So we have been doing strategic buying. So we have got inventories. There is no doubt about that. But if you see the overall picture of total inventories and I think Ashish had talked about it

Ashish Mehta: The inventory days have come down while value would have gone up. As Sanjiv said that, some strategic purchases have been done and we are doing those to ensure that the plant is up and running and we do not see a day where the plant is shut. So that is the intent.

Prashant Biyani: That I understood. But are these inventories 3 or 4 months back when the price used to hover around a bit higher or is it relatively newer when the price has incrementally corrected?

Ashish Mehta: Not really. If you average it out, it is not like that.

S. Nagarajan: So I think typically the way we are purchasing or taking delivery of the material and also speaking on the prices with a relatively shorter horizon, although we have a slightly longer term volume lockup with the vendor, we do not take everything in one shot. So therefore I think the average cost is will be a little bit higher certainly, but it will not be a lot higher, relative to the present cost in this particular technical that Sanjiv alluded to where the prices are showing a downward trend.

Prashant Biyani: The other expenses is down 6% Y-o-Y and as a percent of sales as well, we have seen around 300 odd basis point correction in that. So what would be the reason for that?

Ashish Mehta: Prashant, part of it is of course the optimization of the cost. The second reason is the classification of rent under Ind-AS. So that is why you would be seeing some bit of it, but on an overall basis, at PBT level it is not impacting. It is just a classification which has happened which is a small portion.

Prashant Biyani: So largely it is from optimization of cost?

Sanjiv Lal: Yes.

Prashant Biyani: And just one last question. How has been the retail sale in Kharif and inventory situation for the industry right now?

S. Nagarajan: If you look at the agro chemicals into three buckets in the domestic market- herbicides, fungicides and insecticides - because of the delay in monsoon, our view is that the herbicide business has comparatively held up, but due to the shorter duration that is available for the farmer to complete his Kharif production, he has either shifted to shorter duration crop or gone to shorter duration variety in that particular crop. So for example, people in paddy have migrated to a shorter duration variety or people from maize may have migrated to a bajra for example. Now, the implication of this is that the window of opportunity available for pest and disease incidence has actually come down and therefore the number of sprays we think that are being taken by the farmers is probably going to be a little lower than what it was let us say last year. So if you really look at it at an overall level, we would say that at an industry level, herbicide should be fairly alright. Insecticides and fungicides will depend specifically on the portfolio of the company. If they have products which are very attractive or useful for the farmer, they would certainly get prioritized. But at an average level, there will probably be a small drop for insecticides and fungicides.

Prashant Biyani: And sir inventory situation in the channel of the industry?

S. Nagarajan: Our inventory position as we have mentioned it in the investor presentation also, is quite satisfactory. If there are some companies in the industry which may be having higher stocks or at an aggregate industry level, it is hard for us to say.

Moderator: Thank you. The next question is from the line of Dhaval Shah from ICICI Direct. Please go ahead.

Dhaval Shah: Couple of questions sir, firstly, we have disclosed that the international business has grown by around 31 odd percentage. So out of that, I mean, we started supplying this Metribuzin, so if we exclude that part, so on apple-to-apple basis what is our growth in international market on Y-o-Y terms?

Sanjiv Lal: Why would you want to exclude? Because that is our deliberate action of expanding our international business by growing that category. Why would we want to exclude it?

Dhaval Shah: I mean, just wanted to understand the base products which was in the last year. So how is the traction over there, if you can?

Sanjiv Lal: It is very much part of our base product. It is not new product as such, it has been always there in our export portfolio. Because we see an opportunity, we have expanded the capacity. So it is very much part of our base portfolio.

Dhaval Shah: Yes, that is correct. But the majority of the growth should be driven from the Metribuzin only, right?

Sanjiv Lal: Yes. Because we did mention that there is some oversupply of Pendimethalin. So, growth has come from Acephate as well as from Metribuzin.

S. Nagarajan: In fact in volumetric terms Sanjiv, I might add that we have had growth this first half versus last year first half in pretty much every product. We obviously don't give the product wise growth. Volumetrically, we have grown in every single product. Because of price pressures like what Sanjiv said in Pendimethalin, we have a value drop despite a modest volume growth. But I would say that all the products have grown.

Dhaval Shah: Okay. And for the domestic market, I mean the growth was around 6% on YoY basis. So is this the same growth for the industry for this quarter or I mean, the revision of this credit term's benefit should be seen in the later part of the year. How should we look at?

Sanjiv Lal: Dhaval I think, we can't comment on how the others have performed because I think ours must be one of the earlier results which have come out, so we would of course certainly like to look at how the others in this business have done. But we don't have any insight on that as of now.

Dhaval Shah: Okay. And the last one is on the gross margins, so as you highlighted that some of the key input prices may soften in the next coming quarter, so is it safe to assume 42%-43% odd percentage gross margins can be seen in the FY21? Or, is there any outlook from your side on the gross margins front?

Sanjiv Lal: See Dhaval, while we could certainly have in certain brands, certain categories high margins, but our focus very clearly is on growing the business. Margins will always come in due course of time, either through efficiency and effectiveness improvement or through opportunities which the market presents or through new launches that we will be doing. Our key focus is on growing the business. So I think that is very critical for Rallis at this stage.

Moderator: The next question is from the line of Viraj Kacharia from Securities Investment.

Viraj Kacharia: Just had two broader questions. First is on the standalone business which is the domestic crop protection and the exports part. Now our communication in the past has been that, if you look at the operating margins for both in the domestic and the International business, they are by and large similar. Now the kind of growth we are seeing in exports for last year and a half, we are not seeing much benefit of that translating in terms of margins for us. So one would imply that the margins pressure which you were seeing in the domestic it may be sub 10% operating margin. So if one were to think it from say 2, 3 or 4 year perspective, what will drive recovery in operating margins for us? Is it that it will be only dependent on scale up of new products in domestic market or price recovery in some of the export products. Can you just provide some color how we looking at that?

Sanjiv Lal: So Viraj, one thing we have to be really conscious of that, beyond a certain point it is difficult to pass on costs to the farmer and therefore as an organization what we have to focus on is internally how to improve our cost structure, how we can improve our efficiencies and also how we can buy better. Certainly for newer products because they will also be higher performing products, we can always look at better margins for those categories. But yes, there is a lot of internal focus on improving efficiency and reducing costs.

Viraj Kacharia: So when you talk about improving efficiencies and reducing costs compared to the potential, where will we be in terms of? So why I am kind of stressing again on this point is that, historically we have always been a 15%-17% kind of an operating margin business in the standalone and we are consistently in entire across cycle. What we are seeing in the last year and a half is very different in the trend. I understand that there are pressures on input costs which are there for the industry as well. But the kind of pressure we are seeing is probably slightly higher than what others are seeing in the industry. So I am just trying to understand, how should one understand the sustainability in terms of margin profile in the business?

Ashish Mehta: Viraj, just to answer your question on the gross margin for a B2B business and International business versus the gross margin for formulation products in domestic formulation its much different. The profile is much different. While the opportunity for International growth is there which we are trying to harness through capacity expansion, I believe with the introduction of new products which we have done as recent as the last quarter, the full impact would be seen only in the next financial year. And the company is all out to ensure that the costs are optimized. So we would not like to see that from this percentage to that percentage we will go in the next year. But yes, definitely the target is to ensure that we improve on our margins.

Viraj Kacharia: Okay. The second question was on the export side. We are in the process of achieving the capacity expansion for Metribuzin, we have done phase 1, we are in the process of doing phase 2. If you look at the industry for this particular molecule, the industry is also expanding capacity in the range of 40%-50%. So there is 4,000 to 4,500 tonnes additional coming in the market. This is the product where in the last 1-1.5 years we have seen price more than doubling. So if you can just provide in terms of coverage for this particular molecule, where is the gap in terms of, is there a scope in terms of increasing coverage in existing crop applications or there are new target regions versus the potential? So if you can just provide some color in terms of the drivers for this particular molecule for next 2-3-4 years which can absorb this kind of a capacity coming in the market?

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S. Nagarajan: So as you know this particular space of herbicides is undergoing significant turmoil globally. You have glyphosate which has its own challenges. You have Dicamba which has its own challenges and you also have Metribuzin. So really speaking the final end state of how all of this is going to play out is very difficult to predict. But certainly we think that Metribuzin has some advantages and it is also a product which is in our portfolio which is an area where we are expanding. So certainly, we are finding traction when you talk about the investment that is happening across the industry perhaps that is also reflective of the sentiment that the other players are also having about this. From our standpoint, with respect to the expansion that we are talking about, we have a fairly good line of sight in terms of our business when we are making these investments. So we think that it is a positive area, positive space for us and we are fairly optimistic about it which is why we are also looking at the backward integration project to support the economics on Metribuzin. But having said that, the price levels which have been firm over the last few years, we do expect that there could be some challenges on that as more capacity comes up, that is something which is bound to happen with more players coming in, but not withstanding that we are fairly bullish about Metribuzin.

Viraj Kacharia: What is the price versus volume trend for Metribuzin and Acephate?

S. Nagarajan: Well, price has been going up in last few years You are absolutely right in the case of Metribuzin. Volume also at least in the last few years has been increasing. But what I was mentioning is that right now we are facing some price pressures which is emerging on Metribuzin. And Acephate, I think there are lot of disruptions that are presently underway. So we are actually in the turbulent phase where the raw material for Acephate itself has not been available in adequate quantity. So I think we will have to sort of wait it out for the next 6 months to 12 months to get a clear trend on Acephate. But certainly I think on Metribuzin, we are hopeful that there will be a net increase in terms of business value. If you were to look at it as the crore value of business rather than just the volume specifically or the price specifically.

Moderator: The next question is from the line of Rahul Veera from Abakkus Asset Manager.

Rahul Veera: Sir, just a simple question. In terms of gross margin profile between exports and domestic you said is a huge difference, largely being B2B and the formulation side of it, right? So for the new capacities, how much proportion of that is going to be exports versus domestic?

Sanjiv Lal: Largely our Metribuzin capacity expansion is for the export market .

Rahul Veera: Okay. So I mean, the kind of gross margin that we are seeing unless and until the RM cost improve, we will not see major changes on the GM side, right?

Sanjiv Lal: Yes. So we are looking at doing a backward integration in this particular product which we already approved the necessary CAPEX, so work will be underway in the current quarter for building some part of the raw material being produced internally.

Moderator: The next question is from the line of Ritesh Gupta from Ambit Capital.

Ritesh Gupta: Sir, just to understand. I got a bit confused on the Metribuzin side in last two participant's questions. So basically you are saying that Metribuzin capacities are rising and as a result EBITDA per kg sort of number for Metribuzin has been coming down or may come down. So that is one. And, you have also been looking to take some price hike to mitigate the raw material pressure. That is the other thing that I kind of understood. So if you could just elaborate a bit on the margin from EBITDA per kg sort of number, how do you expect that for Metribuzin and Pendimethalin as more capacities come up?

Sanjiv Lal: No. We did not mention that we will be taking any price hike on Metribuzin, I think it will be a wrong understanding.

Ritesh Gupta: But you expect EBITDA per kg to come down for Metribuzin from here from let us say what the levels we have seen in quarter two?

Sanjiv Lal: No. I don't think we should be too worried about that because there are opportunities for us to expand our business in the overseas geographies. So we will be looking towards that…

S. Nagarajan: Also the backward integration that already we referred to is one of the ways to improve the EBITDA per kg under a declining price scenario.

Ritesh Gupta: Okay. And that is very much Metribuzin specific, apart from that other molecules are not seeing any kind of price erosion or like that kind of a heightened realization that you saw because of China issues last year, it is not that some of those issues are still affecting you?

Sanjiv Lal: Pendimethalin, we have seen a price correction that we have already mentioned that.

Ritesh Gupta: And sir just on the domestic side, like this year also hasn't been that strong for most of the players. So structurally what can change for the industry because I think for last 5-6 years the industry growth, it has been in the mid-single digit sort of a thing or at best has been a mid-single digit growth. And my checks have suggested that incrementally there has been more competition in the same set of molecules even the new molecules that are coming up, you continue to see multiple people marketing those, so there is nothing like an exclusive 9(3) which people are getting. So could you just briefly touch up on in terms of industry environment in terms of the farmers' ability to pay prices for a premium agro chemical product or for a differentiated agro chemical product. Have you seen things changing on the ground on that particular aspect?

Sanjiv Lal: So Ritesh, when it comes to the point that you are making about very similar kind of products in the market and therefore it is important for addressing some of the emerging needs of the farmer which is either being driven by some resistance which is being built up or the fact that every application is costing him money in the field because it requires labour. And innovations are largely around coming up with formulations which reduce the cost of application and I can only say for Rallis that we always keeping in mind the cost to benefit ratio that the farmer will get when he is buying any of our brands. So some of them are on the higher side, but the benefit to the farmer in terms of the overall cost for using it is also to be kept in mind.

Ritesh Gupta: So basically what it could mean is that most of your new launches are kind of focusing a bit more on the combination side or unique formulations etc. or?

Sanjiv Lal: That is correct.

Ritesh Gupta: And sir just on the Metahelix side, in terms of the positioning changes and I think way back in one of the meetings you had said that you may look for an acquisition on the cotton side. Has there been any change in the thought process there or you are still looking out for that?

Sanjiv Lal: I will ask Nagarajan to weigh in on this, but fundamentally cotton is certainly an area of growth for us because compared to the overall market size, we are very small. We have had couple of good products in this category and while this year we have not seen any significant growth over the previous year in terms of cotton, but we have a good plan for the next cropping season. So Naga, you would like to add something more

S. Nagarajan: Yes, absolutely. I think there is absolutely no change in our thought process. We have defined our strategic target areas, where we are open to exploring inorganic opportunities. Cotton is certainly one of them. As already Ashish has mentioned in terms of the cash flow from operations also, we feel that we are adequately supported from the standpoint of chasing potential targets, but having said that, it will have to fit in with our strategic objectives and it will also have to be at the correct price that we think is appropriate for that. So subject to those conditions, we are always on the lookout and cotton is clearly one of those areas.

Moderator: The next question is from the line of Abhijit Akella from IIFL.

Abhijit Akella: The domestic revenue growth in the first half, would it be about high single digits?

Sanjiv Lal: Yes, it will be about 8%.

Abhijit Akella: And within that, is it largely driven by the institutional business or has the formulation business also grown?

Sanjiv Lal: Largely, formulation business.

Abhijit Akella: And second just on the CAPEX for the first half, it has been only about Rs.150 crore compared to our guidance of about Rs.200 crore for the full year. So do you expect a big step up in the second half now?

Sanjiv Lal: Actually because of lot of flooding and all which has happened in the Dahej area, there has been a bit of a slowdown on some of the work that we were doing at that site. In fact we are just on the verge of awarding the contracts for the construction, so we will see a larger cash outflow in terms of the CAPEX program in Q3 and Q4.

Abhijit Akela: So the 200 crore number still stands?

Sanjiv Lal: Yes, largely plus minus little bit, yes, we are still targeting that.

Abhijit Akela: And the tax rate if you could just give us some guidance on how you should think about it for the standalone as well as the seed business going forward?

Ashish Mehta: Abhijit, on the seed business, I think in Q1 we had said that part of the income has been recognized as agriculture income and hence, we did see a drop in the tax rate in the first quarter which we had already intimated. Coming to standalone, currently we are at the existing rate. The new rate which has been announced we will be going in for the next year, the 25.17% rate of taxation.

Abhijit Akela: And there is an increase in the Depreciation expense in the subsidiaries in this quarter on a sequential basis, it is up by some 4 crore?

Ashish Mehta: Rent which is the lease rent as per Ind-AS which has to be reflected from other expenses to depreciation. You have to factor the lease rentals over a period of the lease period and then show it under the depreciation and amortization, so that is the impact.

Abhijit Akela: So this quarter's run rate is a steady run rate now going forward?

Ashish Mehta: Yes.

Abhijit Akela: One last quick thing if I may squeeze in, sir, given the outlook for a good Rabi season, how strong is our portfolio in terms of say, hybrid maize or some of the other crops that may do well? Are we positioned to capitalize or it will take some time for us to get ready for the Rabi season?

Sanjiv Lal: Rabi season this year will continue to be a bit of a challenge for us because we don't have Rabi maize with us yet, we are still trying to finalize co-marketing product in that category, but as you may be aware that we have reorganized our vegetable seeds business to make it into like a line of business and that team has been put together, so there will be considerable focus on getting that category to kick in to help in the H2 sales. Nagarajan, you like to add something more to that.

S. Nagarajan: . Apart from that of course mustard is something which we should expect to grow better than what we did last year but specifically on Rabi maize, it will take some time.

Moderator: The next question is from the line of Chirag Dagli from HDFC Mutual Fund.

Chirag Dagli: Sir, has there been any shift in the season sales into the third quarter or is Kharif pretty much reflected in the first half?

Sanjiv Lal: In fact Kharif is continuing well into October, so the season at least in certain parts has really got shifted considerably, Eastern region in particular has shifted quite a bit, so we are still in Kharif in some regions.

Chirag Dagli: So for Rallis, how many days would have shifted into third quarter? How many day's sales for the season?

Sanjiv Lal: I guess at least two weeks.

Chirag Dagli: And sir, would you say that the first half margins for the branded business are impacted by the fact that you have higher priced inventory and you have not been able to, while the end product prices continued to be lower because it is very competitive environment?

Sanjiv Lal: I will say that could largely be the reason you can attribute.

Chirag Dagli: And why is it that you are not able to pass on these prices into the market? Is it because competitors have lower priced inventory?

Sanjiv Lal: Some of these products are established products where the farmer has been buying it at a particular price point and I don't think the farmer would be willing to pay a higher price point because we want to pass on no cost to him, so we have not changed the price of some of these very popular brands of ours.

Chirag Dagli: So then this should get fixed in the second half, right sir?

Sanjiv Lal: There will be some improvement, no doubt.

Moderator: We will move on to the next question that is from the line of Varshit Shah from Emkay Global.

Varshit Shah: Sir, just two questions, first on Metahelix, I think we have seen good performance there because of the shifting crop but towards shorter duration, if I want to just make this question to a larger picture suppose if next year in the Kharif, the rains are more spread out and normal, then actually growing at this kind of rate could be a little challenge, is my assessment correct? And my second question is on the new product launches in domestic market, I think you have mentioned in the presentation that you will be launching another 11 odd products, so does this include the five of this fiscal year or it is excluding this?

Sanjiv Lal: No, this includes the five that we have already talked about, so we will be getting about two new products coming in every year. We will be having two new formulation products coming in every year.

Varshit Shah: So and my question on Metahelix, so I think we had a boost from late sowing and shift towards short duration paddy, so is my assessment correct?

S. Nagarajan: I think the way we would look at it is as follows; we have 4 major crops which help us to diversify between the different situation and within each crop, you have different duration, so for example, in paddy we have short, medium and longer duration hybrids and similarly in the case of maize as well, so I think this time what happened was shorter duration varieties, we have done better and Bajra has done better because the climatic conditions were more favourable for that. However, I think the portfolio which we have, I think should be able to accommodate other kinds of situations as well, for example, we could have done better in mid maturity rice, for example, if the weather conditions had been somewhat different and we have a good set of products there, so I think we would probably suggest that you may wish to consider it as the diversification across the portfolio.

Varshit Shah: So we are prepared for all weather patterns, is this what you are saying?

S. Nagarajan: Certainly, we have some areas where we are stronger and somewhere we are still trying to build our strength, but our endeavor is really to insulate ourselves as much as we can from this kind of weather vagaries.

Moderator: The next question is from the line of Vishnu Kumar from Spark Capital.

Vishnu Kumar: If you could just elaborate on your dealer acquisition policies and how is it likely to pan out in the next year or so?

S. Nagarajan: So, well I think what you see is that it is important to have the right kind of channel partners, more than just the number of channel partners, and that is what our focus is. It is not that we are looking for chasing certain number of retailers or certain number of distributors. As we have called out in the presentation, we have something like 3,600-3,700, what we call SS and PD and about 41,500 retailers for the agrochemical business. What we have done is we have kind of reenergized some of the elements of the policy, notably we have increased the payouts pertaining to prompter payments, things like advance booking and so on which I think had satisfactory effect because of the way the collections have moved as we can see the accounts receivable this year is at the same level as the last year, despite there being an increase in revenues of 14%. So I think our focus is really to look for quality partners and look for partners in geographies where we have identified as weak areas and the third element is to do it in a 360 degree fashion which is to examine the existence of the suitable product for that area where we are looking to strengthen our channel, so that we are able to maximize the benefit. So I guess these would probably be the three principles which we are applying for our channel expansion.

Vishnu Kumar: Sir, is your number of days increased or it is just that you have increased the discounts if like the payment is made promptly?

Ashish Mehta: The pricing policy is made to such an extent that the dealer gets incentivized by making early payment, not to say that the high payment incentive is part of our cash discounts what we give.. It is more of a restructuring of what we have done and the dealer sees more gains by making upfront payment or even making payment on the due date, hence the structure is made in such a way that if you make payments at different time slot, we get provide different levels of cash discounts and that is where they see more advantage rather than linking the incentive to an off take plan which was earlier done.

S. Nagarajan: Actually, as you know this time, the liquidity in the market because of various issues which you are very familiar with has been quite difficult and we prepared ourselves. I think now retrospectively we can say a little better by encouraging prompter payment and also advance booking, so we were able to actually realize a lot more through collection, but this is within the overall ambit of our trade margin structure, so it was a restructuring like what Ashish called it, but I think in hindsight, it seems to have worked satisfactorily.

Vishnu Kumar: Just to summarize, you basically kept the credit period same, but you just incentivized them for prompter payments by giving them some kind of discount on or reduced kind of prices for faster payments?

S. Nagarajan: No, we actually relaxed a bit on the credit periods also, but we complemented it with incentives to **pay quicker** so effectively the behavior has been that people have paid faster.

Vishnu Kumar: And on an average, I understand this model helps you slightly lower margin but better cash flow profile for you, is it possible to quantify what would be the margin impact, may be 1% or 100 bps, 200 bps, any of that kind of working if you would have?

Sanjiv Lal: I think let us not get into that detail Vishnu because we have to see what is going to support our overall growth plan, so we thought that this would be a good approach to encouraging our trade partners to turn around their cash faster and also gives them the opportunity for their own growth as well.

Moderator: We will move on to the next question that is from the line of S Ramesh from Nirmal Bang.

S. Ramesh: First of all, can we understand the key geographies which have contributed to your growth in the International market and some colour on the volume growth you have got in the domestic and international markets?

Sanjiv Lal: So our key driver for International business is largely coming from North America as well as Brazil and we are also trying to build our portfolio offerings in both Africa as well as South East Asia, so these are much smaller markets, but we see them as important markets going forward, but the larger volume growth is coming from North America and Brazil.

S. Ramesh: And can you give us a split in terms of the volume growth for the domestic and international market for the first half?

Ashish Mehta: It is already given in the results documents.

S. Ramesh: Sir, that growth number is the volume growth?

Ashish Mehta: Yes, most of it is volume. See overall if you see the Q2 as well as the H1, larger growth has come from volume part, both for domestic and international business

S. Ramesh: So if you are looking at the second half and then next 2 years, see, second half last year, you had a problem in terms of the margins, so what is the kind of internal planning you have for the second half in terms of say, topline growth, if you are not able to split that into volume growth and pricing and what should we expect in terms of the bottomline numbers? Will it be similar to the first half?

Sanjiv Lal: Ramesh, we will not be able to give you any detail on that except to say that our focus is on growing all our categories, whether it is a domestic formulation business or International business, so we will be clearly focused on making available more and more products and that is why I had mentioned that we are ensuring that our factories are supplied with enough raw materials, so that they can run through capacity.

Moderator: The next question is from the line of Nitin Agarwal from IDFC Securities Limited.

Nitin Agarwal: Sir, question is on the International business, right now the business has dominated largely by Metribuzin and Pendimethalin, now after the large investment plan that we have for the export business, how do you see the complexion of this business in terms of product concentrations are changing over the next 3 to 5 years?

Sanjiv Lal: Actually we have got 3 major products, 2 which we have mentioned including Acephate which is the third and of course we are the largest producer of Hexaconazole, so these are our 4 big products and we have taken up work at our research centre for what you may call reverse engineering for some of the active ingredients which we feel could give opportunities for us, so that work is currently underway and over the next 3 to 5 years, we will be adding capacity for making some of these active ingredients which offer good opportunity.

Nitin Agarwal: So is it fair to say for the next at least 2 to 3 years, these current 4 products will largely dominate the export business and I guess subsequently we will probably see a little more diversification happening on it?

Sanjiv Lal: I would say over the next 2 years, these will continue to dominate till we have newer products which are helping to further diversify.

Moderator: The next question is from the line of Bharat Gupta from Edelweiss Securities.

Rohan Gupta: Sir, my question is on CAPEX, so we initially guided for roughly Rs. 800 crore spending over next 5 years that was the entire game plan for the company. We have almost Rs. 250 to Rs. 350 crore visibility for next 1-1/2 years. Recently, the text incentive which is announced by the government, so the balance Rs. 500 crore CAPEX which we had planned for next 3 to 4 years, do we see that there will be any change in that strategy to benefit on the tax incentive or we will accelerate that CAPEX to benefit that? Any thought process on that?

Sanjiv Lal: So, we are still trying to fully understand because it is talking about setting up new companies and all, so we are able to avail the lower tax rates, so these things need to be fully understood before we make those kind of commitments but as of now, our path is very clearly defined in terms of what all we need to do immediately and there are things which I had mentioned in response to the earlier question regarding adding capacity for newer active ingredients, so that we will have a better line of sight by early next year in terms of what capacity we will be adding, for which active ingredients.

Rohan Gupta: So as of now, all that thing will come under the current structure only, not any new company will be formed and then you will see….

Sanjiv Lal: As of now, there is no change in our approach but we will examine the opportunity that the new ordinance has indicated for new companies to benefit from lower tax rates.

Ashish Mehta: Rohan, it is also important to see that while the new company has to be formed new investments has to be made. It also needs to be seen what is the new company going to produce and how it is going to sell, so we have to evaluate the tax angle also in terms of GAAR, in terms of related party transaction, in terms of arm's length, so all those considerations are very important before we come to a conclusion, but yes, the new tax rate does offer a lot of opportunities. Also given that Metahelix is getting merged with Rallis and the benefits what you get in terms of the R&D spent also needs to be seen.

Rohan Gupta: Sir, second question, on the margin front, though you mentioned the gross margin definitely under pressure because of very volatile raw material prices and higher cost of input, but sir we being Rallis are fairly backward integrated and of 34% gross margin for our kind of company, definitely compared to many other companies, is much on a lower side, so my concern and worry is that have we lost our cost competitive shape which we used to have earlier and now the China and the raw material dependency on them has been much sharper and that is why that we are seeing this kind of margins or it is just only your cautious strategy to cut the prices and penetrate more deeper in terms of through the customer that is leading to some short-term volatility in margin and we ultimately will gain to the earlier level of margins?

Sanjiv Lal: We have not cut any prices Rohan nor have we taken any price increase. Therefore what we had mentioned earlier is we have not passed on any cost increase to the farmers, it is also impacting the margin structure.

Rohan Gupta: So that is definitely on the domestic side, I am more saying in the International business because that is roughly 35% for us and I believe that margin pressure probably will be more in International business or our export business or it is across the board, it is domestic as well as International both?

Sanjiv Lal: We cannot make a statement which will brush all products in the same category. There are some products when there is a margin erosion and we talked about Pendimethalin where there is pricing pressure, but on other products there is not so much of pressure yet but it could happen that we may have a situation where we have to adjust prices downwards.

Moderator: The next question is from the line of Rohit Nagraj from Sunidhi Securities.

Rohit Nagraj: Sir, you mentioned about the cost benefits from optimization of cost, what is the kind of benefit on the operating level that we expect this year and next year in terms of 50 bps, 100 bps or so?

Sanjiv Lal: Rohit, I don't think we have articulated that. We are working towards that. We will certainly see it playing out over the next couple of quarters in terms of our cost structures.

Rohit Nagraj: And sir, second question is on Metahelix, so last year the effective tax rate was close to about 22% and given the commentary this year, the tax rate will be Zero or how is it going to be?

Ashish Mehta: Rohit, I think we had mentioned in our Q1 what is the new tax rate for the current year for Metahelix because part of the income is being considered as agriculture income, so there is a drop in the effective tax rate compared to previous year. The entire revenue is not considered as agriculture income, it is only part of the activity which is relating to seed production is being considered as the agriculture income, so while we get the advantage but the drop in this tax rate is not so high but we will get that.

Moderator: The next question is from the line of Amar Maurya from ALFAccurate Advisors.

Amar Maurya: Sir, my question is primarily on the revenue mix and the margin. If I see your second half, second half is largely dominated more towards the export business because of the overall mix and given that now the new capacity, the second phase is also going to come by December, so the overall mix is further going to be skewed towards the export. In this revenue mix change, how should I see the second half margin given that your last year second half margin was significantly lower probably in the history of the company?

Ashish Mehta: Amar, actually in Q3 and Q4 there is a combination while Q3 has domestic sales as a major player, in Q3 and Q4 we also have international business and we also have the contract manufacturing orders also getting executed largely in Q3,so the combination of this definitely pulls down or has an impact on the margins. As mentioned earlier that there were pressures in Pendimethalin in the overseas market, we need to see how it pans out for the Q3 and Q4 because it is not a period specific sale, it happens throughout the year, so we need to evaluate and see how the margins or how the pricing pressure, will it continue or will not continue in the Q3 or Q4. For products under Contract manufacturing prices are all fixed at the start of the year.

S. Nagarajan: I think how do you look at H2 that is the point, I would say that there are three things that will influence, three factors we wish to consider, one what we said about the mix, the second is of course with respect to last year to this year, I think there is a substantial difference in the outlook for Rabi, so that is the second factor you may wish to factor in and the third is of course the raw material and the end product prices, how they are likely to fluctuate, so if you take these three factors into account, I guess you could form a view about how H2 might be.

Amar Maurya: So sir, like alluding to your connect what you are saying is that Rabi relatively looks better than last year, and secondly, if I see the outlook of export, export is largely going to be better because of the new capacity and other things, so I mean what are the early indications from your side because I believe '19 second half was significantly depressed in terms of the margin, then your historical if I see probably 20 quarters?

S. Nagarajan: Unfortunately as you know we don't give forward guidance, so therefore I can't give you our view but these are the factors that you may wish to consider to project H2.

Amar Maurya: But then any early indication, is it like worse than the last year or better than the last year?

Sanjiv Lal: I think we are all very hopeful that because of good availability of water, the Rabi is going to be fairly good and we hope that for us also it will be much better than last year.

Amar Maurya: It is also on the margin and the revenue both?

Sanjiv Lal: In terms of margins, we had already mentioned that we are seeing some improvement in pricing on couple of the key raw materials, so that should help us in slight improvement in our margins.

Moderator: The next question is from the line of Siddharth Mohta from Principal Mutual Fund.

Siddharth Mohta: Sir, my question is on two new 9(3) molecules which we have launched recently, so to which segment of crop does it target? Second is the opportunity size for this 9(3) molecules and what cost benefit does this molecule brings versus similar products?

S. Nagarajan: The two products that we have launched are chiefly for the paddy crop, one is called Zygant, the other is called Ayaan. Zygant is the formulation which is the granule formulation which is aimed for the stem borer insect segment. It is typically applied 15 to 25 days after the transplantation of the paddy crop and we have priced the product at a premium position. We have had fairly strong launches which have been very well received by both the channel partners as well as by the farmers. In fact, I think our demand has been far higher than what we could supply as far as this particular Kharif season was concerned but of course these are early days and we are augmenting our supply position. The second product is called Ayaan which is actually aimed at sheath blight disease and is also for the paddy crop. It is applied between 25 to 40 days after the transplanting and it is unique product because it is Strobilurin plus Hexaconazole combination and the early trends on this product have also been quite encouraging. Even on this products, we have been able to supply lesser than what the demand has been, so we are hopeful that both these products in the Rabi season, we should be able to witness much better traction.

Siddharth Mohta: Sir, so what would be the opportunity size if I have to combine both the products and what cost benefit analysis does it bring versus similar product?

S. Nagarajan: In terms of Zygant, the benefit is in terms of the longer duration of effectiveness after the application that the product offer, so from a farmer standpoint while he may be spending a little bit more per acre, to use this product hemay be able to avoid the number of applications that he would otherwise have to do, so there is very clear value proposition in the case of Zygant. Similarly in the case of Ayaan also, there is a very clear value proposition because as I said this is a mixture of Strobilurin and Hexaconazole. Hexaconazole is our already strong product and we are the only producers of Kresoxim-methyl which is the Strobilurin which is there on this particular product. Out ofthe opportunity size of the overall paddy market of about Rs.4,000 crore, probably about Rs.200, Rs.250 crore, may be even Rs.300 crore could be for each of these products.

Moderator: Thank you. Ladies and gentlemen that was the last question. I now hand the conference over to the management for the closing comments.

Sanjiv Lal: Thank you. We had a number of questions which we hope has been able to give clarity on our H1 performance. As we have mentioned that the Rabi season in India seems to be looking very promising, as a company I think we are well positioned as far as the crop protection and crop nutrition category is concerned to be able to give the best kind of products to the farmers. Our Seeds category as already discussed, there is some weakness, we are trying to see what best we can do with our fruits and veggie category to smoothen out the H2 sales, so we are quite bullish and buoyant on a good Rabi performance and at the end of it, it is the farmer who needs to win, so I think he has got good things going for him in terms of water availability and as a company, we have the right products to support him for the Rabi season, so all the best and we will catch up 3 months from now with the Q3 call. Thank you.