sugar ethanol power

Shree Renuka Sugars Limited
Quarter ended 31st December 2011 Conference Call Transcript
February 15th, 2012

Moderator

Ladies and gentlemen good day and welcome to the conference call for Shree Renuka Sugars Limited to discuss the results for the quarter ended 31st December 2011. As a reminder, all participant lines will be in listen only mode and there will be an opportunity for you to ask questions at the end of today's presentation. If you need assistance during the call, please signal an operator by pressing * and then 0 on your touchtone phone. I would now like to hand the conference over to the management. Thank you and over to you.

Narendra Murkumbi

Good evening friends. Thank you for dialling-in to our earnings call for the quarter ended 31st December 2011. I think you already have our earnings release and presentation. Also, this time we have had a little longer gap between our release and the call in order to give people more time to study the numbers. So, I will not ask my colleague Mr. Kumbhat, CFO, to go through the numbers again. I will straight away go into the outlook for the business, what we are doing and what the industry is looking like.

After the negative shocks that we had in the last quarter, this has been a stable quarter. We continue to make progress in rectifying the problems, especially with our cane fields in Brazil and in our efforts to shrink the size of the balance sheet in Brazil. That has been our main focus over the last three months.
As far as the external outlook is concerned, in the last call, I spoke about the emerging situation in India. I think since then we have probably seen progress towards the kind of scenario which we had predicted back in November. In Renuka (India), I think our cost of production is one of the lowest in the country. In our milling division, we are witnessing the best recoveries we have ever had in 12 years of the history of this company and we are positioning ourselves for an environment where production could drop in the coming years.

Coming to our refining business, until the last quarter we had poor refining margins but refining margins have since improved and in the current quarter we have our new Gujarat (Kandla) refinery working close to its full capacity. In fact, we have refined, more raw sugar in current quarter till date than in the whole of the last quarter and we continue to see good availability of domestic raw material.

Coming to the global market and then to our Brazilian business. As far as the global sugar market is concerned, for 2012 there is a surplus, which depending on the analyst or organization, is predicted between 4 to 8 million tonnes. Most of the increase in production in 2012 is expected to come from Europe, both Eastern Europe and Western Europe. The cause is that the last 2 years when world prices were largely between USD 25 cents /lb and USD 30 cents/lb, it provided a very high incentive for some of the wheat growing countries to plant more sugar beet. Cumulatively, the entire European production is up by almost 5 million tonnes. We have a small increase expected in India which may or may not materialize and we estimate a marginal increase in Brazil which is expected to be about 1.0-1.5 million tonnes more than the actual production of last year. In Thailand, we expect a flat year of production and so in Australia.

World sugar prices have moved from a range between USD 25 cents/lb to USD 30 cents/lb. Since November they have been moving in a lower, much tighter and less volatile range between USD 23 cents/lb and USD 25.5 cents/lb. And going forward, there will still be fairly good demand, especially restocking demand for sugar because many countries had brought down their stocks a lot. While prices have come down, demand outlook is fairly firm. We do expect that prices could move down further closer to the range of USD 20 cents/lb to USD 22 cents/lb when the Brazilian harvest season starts in 2012-13. However, initial estimates for 2013 are for a smaller surplus. In 2012, while there is a surplus, I do not think prices will really go down too much because we have a lot of restocking demand from most of the major importing countries and because we have a substantial unmet demand for ethanol in Brazil which will kick-in once the ethanol price falls below the parity price against gasoline. If we produce additional ethanol instead of sugar at prices below USD 21 cents/lb, that will take away some of the sugar surplus. And thirdly, we do expect that many of the traditionally importing countries like those in Europe, which have large crop this year, will not be able to sustain the current level of production in the next year because sugar prices are lower and their break even cost of production is above USD 25 cents/lb. This is as far as the outlook for the global market is concerned.

In terms of the global ethanol market, there has been a very positive development at the end of December-2011. The United States government has ended its import tariff on ethanol from overseas and that tariff on an ad valorem basis was equal to almost 17% of the price; 46 cents per gallon of ethanol. We are seeing substantial export demand from Brazil for California which is a consumer of more than 10 billion litres of ethanol and, more importantly, does not use corn ethanol since it does not meet its criteria for sustainable bio-fuel in terms of its energy balance. Effectively cane ethanol from Brazil is the only viable commercial source right now for blending in California.

In terms of the Brazilian market, right now the car fleet has again grown by about 3.4 million cars last year of which 83% were flex-fuel cars. The pool of potential ethanol demand has grown by about 3.5 billion litres. However, actual production of ethanol has actually dipped year-on-year. Therefore, more than 50% of cars that can currently use 100% ethanol are not using ethanol but are using a blend of 80% gasoline and 20% ethanol which is called 'gasoline C' in Brazil and which is the main gasoline blend that is sold in the country. So, we have a very large unmet pool of fuel demand where ethanol is competitive, provided it trades at equivalent of about USD 21 cents/lb. That is the reason for our confidence that further substantial decline in price of sugar is not warranted for any period of time.

Coming to our Brazilian business, in the last quarter we ended our crushing in line to our guidance in the middle of November of about 8.3 million tonnes of cane crushing. It has been a bad performance compared to the earlier estimates and lower than last year. The main problem was in Renuka do Brasil. Our main task there is to renew the cane plantations and as a part of that plan, we had a target to plant about 20,000 hectares of cane in 2011. We have achieved that target in the middle of December. Similarly in Renuka Vale Do Ivai, despite a 10% loss in yield, we operated at about 75% of capacity. In that company, we have planted more than 5,000 hectares. Combined in both the companies, we have renewed and replanted new cane in a proportion much higher than the average industry level in Brazil this year and we do expect that to help us in the coming year.

As far as the divestment of cogen assets is concerned, we are continuing to pursue that as our top priority. We had hoped to announce something by the time of our earnings call i.e. now, I expect us to finalize the preferred bidder in a couple of weeks' time. Deleveraging the Brazil balance sheet remains our top priority.

In India, I think we are operating very efficiently. We are achieving one of the best operating results we have had in our history. But our effort is to increase further the capacity utilization of our refineries in the short-term and for next year. I would like to wait till about the end of March to really have a very firm view on what the outlook for the next season looks like. I think the problems with the industry, especially with the State Advised Price (SAP), are pretty much well known. They are in the press now almost on a daily basis. And we are well positioned to take advantage of any disturbance in the cane planting because of these reasons. With these few opening remarks I would like to open up the forum for questions.

Moderator

Thank you very much. We will now begin the question and answer session. We have the first question from the line of Mr. Nirav Shah from Antique Stock Broking. Please go ahead.

Nirav Shah

My first question is can you share the revenue and EBIDTA details of our Dubai subsidiary for this December 2011 quarter and for the 15-month period?

Narendra Murkumbi

For the 15-month period turnover is about Rs. 1,889 Crores and the profit after tax is about Rs. 148 Crores

K. K. Kumbhat

For the quarter Rs. 605 Crores is turnover and profit is Rs. 14.4 Crores

Nirav Shah

My last question is what are the target recovery rates for Indian operation in this season and Brazil operations next year because you have done a lot of new planting that can possibly improve recovery rates?

Narendra Murkumbi

I will speak about India first and then Gautam will talk about Brazil. In India, our recovery to date is above 11.5% and it is possible that it will end close to 12% for the whole season. But for the last quarter, the actual number, since it is the starting point of the season, is a little lower at around 11%.

Gautam Watve

For Brazil we are considering a recovery of 13.5% which is a little more than last year in terms of the sugar or ethanol recovery. In terms of the cane yields, we are taking an average of 65 tonnes/ha in Renuka do Brasil.

Nirav Shah

Thanks a lot Sir. I will come back in the queue if I have more questions.

Moderator

Thank you. We have the next question from the line of Sanjay Satapathy from Merrill Lynch. Please go ahead.

Sanjay Satapathy

It looks like the refinery division has started doing much better. Can you give us a sense of the spreads right now and how sustainable it is and also what are your targets for refining for this quarter as well as next year?

Narendra Murkumbi

We have started refining domestic raw material from the end of last quarter, let us say, from this quarter itself, we have booked purchases of about 3 lakh tonnes of raw sugar from India. The current EBIDTA margin is approximately about $60/tonne and we hope to do about half-a-million tonnes from domestic raw sugar and in the last quarter possibly, again depending on how the India supply-demand balance looks for the next year, we will be going back to Brazilian supply for raw sugar. So for the next two quarters we will be relying on domestic raw material.

Sanjay Satapathy

For FY13, how much one can really expect to refine?

Narendra Murkumbi

Well, I think we have clear visibility for the next two quarters and beyond that I would probably like to give a view in the next earnings call. But across the board, on the futures market refining premiums, which were below $100/tonne are now above $100/tonne and they are moving up steadily. So I am quite positive on the refining margins going forward.

Sanjay Satapathy

How does the capacity utilization of the refinery influence the EBIDTA margin at this point of time?

Narendra Murkumbi

Because of the gap between fixed and the variable cost, if you run at full capacity versus half capacity you would have a further reduction in per unit cost of about $12.

Sanjay Satapathy

My last question is related to the Brazilian operation. Now that you are looking at improvement in yield to about 65 tonnes per hectare, what kind of reduction in cost structure can we really look forward to in next year that is in FY13 versus FY12 season at the EBIDTA level?

Narendra Murkumbi

Well, if we are only at 65 then the reduction in cost will only be about 10% which is about 2 cents. For us to get back to a 14-15 cents variable cost, we would need a yield of about 80 tonnes per hectare.

Sanjay Satapathy

Is that something which is a remote possibility for FY13?

Narendra Murkumbi

Well, in VDI I think we are almost definitely going to have a yield over 80 tonnes this time. In RDB, I do not think we can touch 80 tonnes/ha this year. Most analysts expect Sao Paulo state to have a yield of about 70-72 tonnes/ha in the coming year. We are currently modelling at 65 tonnes/ha as against the estimates of 70-72 tonnes/ha by independent analysts for the state of Sao Paulo.

Sanjay Satapathy

With VDI at 80 tonnes/ha, your cost will be 14 cents/lb and for RDB would it be something 17-18 cents/lb?

Narendra Murkumbi

For VDI it will be about 15 cents/lb and for RDB it will be around 18 cents/lb at the current exchange rate.

Sanjay Satapathy

This is the cost at the EBIDTA level?

Narendra Murkumbi

That is right.

Sanjay Satapathy

Thanks a lot Sir and wish you all the best.

Moderator

Thank you. We have the next question from the line of Achal Lohade from JM Financial. Please go ahead.

Achal Lohade

Good Evening. Just a couple of queries. First, can you talk about the hedging strategy for the next year? How much have we hedged for the coming season and what is the hedging on the Forex side?

Narendra Murkumbi

In Brazil we do not hedge exports on forex. We take it at a spot price because we have a substantial Dollar exposure on our loan. On the sugar side, in both companies, we have hedged about 50% of the exports with a floor price of USD 24 cents/lb and an average cap price of about USD 29 cents/lb. Depending on where the market is in the 3rd and 4th quarter of the current calendar year, if it is lower than USD 24 cents/lb we will have a minimum price of USD 24 cents/lb and we have an upside to about USD 29 cents/lb. For the other half we are deliberately not hedging now because I think the outlook for world's futures prices beyond June will be driven largely by the Indian and European crops for 2013. If we continue to have prices below USD 25 cents/lb in the world market now, we believe there could be a substantial reduction in both these crops and, therefore, we consciously are not looking at hedging the entire crop right now.

Achal Lohade

The other question is actually about the results. If I look at the standalone numbers, the other expenditures have dropped sequentially as well as y-o-y by 30% to 50%. Just wanted to get a sense as to what was the reason and do you think this is sustainable? How does one build in going forward?

K. K. Kumbhat

For any quarter which is your manufacturing quarter, the expenses are loaded in the inventory and, therefore, you will have less expense here but in a quarter which is not a manufacturing quarter you will have expenses straight going to the P&L.

Achal Lohade

Y-o-y also, it is down actually from 89 Crores to 60 Crores. Just wanted to get a sense on that?

K. K. Kumbhat

One of the main components here is freight. When you export more material, you book more freight because your export turnover is basically including freight. Since trading volumes have gone down the freight volumes have also decreased and, therefore, you have reduction here.

Achal Lohade

On the debt front, have we been able to reduce the debt of the Brazilian companies?

Narendra Murkumbi

Well in Brazil, we have a small repayment of debt every quarter. I would say that roughly it is the same as the previous quarter.

Achal Lohade

And standalone, the interest cost has gone up from Rs. 40 to Rs. 71 crores. Is it only because of the working capital increase or it is also to do with the funding of the increase in stake in RDB?

K. K. Kumbhat

Well, if you look at our interest cost it has gone up by almost Rs. 30 Crores in this quarter. One of the reasons is that overall interest cost itself is high. If you look at our opening utilization of Rs. 3,300 Crores average cost has gone up by about 1%. Net effect for the quarter is about Rs. 8.5 Crores. And there is an incremental working capital requirement because of season and purchase of local raw sugar for refineries. The incremental money has come at an average rate of about 12%. The cost for the quarter is about Rs. 21 Crores and in total Rs. 30 Crores.

Achal Lohade

Thank you so much Sir.

Moderator

Thank you. We have the next question from the line of Vikash Jain from CLSA. Please go ahead.

Vikash Jain

Thanks for taking my question. Could you give me the breakup of standalone debt into long term and short term, the absolute numbers?

Narendra Murkumbi

Well, it is about half and half, Vikash.

Vikash Jain

The absolute amount of Rs. 3,300 Crores?

Narendra Murkumbi

Absolute amount at the end of December was about Rs. 4,000 Crores taking into account the seasonal build up of inventory domestically.

Vikash Jain

So would we get closer to Rs. 2,000 Crores as the season ends or close by in the sense that a large part of the working capital loan would be paid off?

Narendra Murkumbi

Our financial year now is going to be March.

Vikash Jain

I am talking about the season end, so next six months?

Narendra Murkumbi

I will answer for both. I do not expect any increase in the debt of March. So whatever we have in December will continue for March. The decision for September is going to be more interesting. It will depend on the inventory that we choose to retain into the next year. Now depending on the outlook for the business and for domestic sugar prices, we may choose to have more inventory or less inventory depending on price outlook. As you can see even today, the domestic market is below the world price. In a situation where India is still an exporter of sugar, that is probably justified. But if we are not going to have any exports next year, which looks a fairly good possibility or you are going to have a small amount of imports, the price would move up substantially. That is what the decision will be based on and inventory figure will decide the debt level in September.

Vikash Jain

Just one thing, on the roughly Rs. 2,000 Crores of long-term debt at standalone. Could I have the repayment for the next 3 years? I mean what is the repayment obligation that we have for FY2013, 2014 and 2015?

K.K. Kumbhat

Over next 3 years it is about 40%.

Vikash Jain

40% and broadly equally divided, is it?

K.K. Kumbhat

Yes, more or less.

Vikash Jain

In case of the sugar hedge that you just mentioned, what is the absolute quantity? Total Brazil, you said 50%, what does that equate to?

Narendra Murkumbi

About 4 lakh tonnes is the hedge; the expected production is 8 lakh tonnes between the two companies.

Vikash Jain

One more thing on Brazil again. The depreciation, does that vary on sales which we make or on the production? And secondly, cost of sugar sold for the next quarter, would it be very similar to what we have in this quarter since a large part of the manufacturing expenses are taken care of?

Gautam Watve

The depreciation is based on the sales volumes that are there. That is how it gets filled over the quarters and for next quarter the cost of production should almost be the same.

Vikash Jain

So is it production or sales?

Narendra Murkumbi

Sales.

Vikash Jain

Okay. That's it. Thank you so much.

Narendra Murkumbi

Vikash, as you have seen, we are now disclosing different heads of depreciation in Brazil because it is very different from the way you have depreciation in the Indian operations. You have agricultural amortization, off-season maintenance, etc.

Vikash Jain

I really appreciate the details. I think it is very helpful for anybody who would want to model the business. Thank you.

Narendra Murkumbi

Thank you.

Moderator

Thank you. We have the next question from the line of Arya Sen from Jefferies. Please go ahead.

Arya Sen

Good evening Sir. Firstly, how much are you paying for cane in Maharashtra and are there cane arrears in Maharashtra as well? What is the situation over there? And if farmers are likely to switch out of cane what would be the crops they would switch into?

Narendra Murkumbi

Cane price in Maharashtra is between Rs. 2,300 and Rs. 2,500 per tonne delivered at the mill. Maharashtra is running at an average of 11.5% recovery. In terms of cost of manufacturing today, Maharashtra is at about 25% lower cost of manufacturing per tonne of sugar compared to North India. On the cane arrears situation, there is a lot of pressure on payments because the co-operative banking system is not able to give working capital to all the mills in the state because many of them are not meeting the net worth criteria, etc., and the bank is now under RBI administration. So there is severe pressure. We expect arrears in Maharashtra. Normally, they are very small because the state government always bails out the co-operatives. But this year, we do see a build up of that happening, especially in the months of February and March. I had a number of 1,700 Crores for arrears as on 15th of January. I think the big numbers will start becoming visible in February and March as people come to the end of their working capital limits.

In terms of crops, sugarcane is still clearly the best crop. But if you see in Maharashtra now, there is very little irrigated area left which can sustain cane. Whoever could have planted cane has already planted cane by last year. Area is up only about 3%. Yields are lower by about 10 tonnes per hectare across the state and also across Karnataka. Latest estimate is that Maharashtra will have about 5 lakh tonnes less production than last year and Karnataka will have between 2 to 3 lakh tonnes less sugar production than last year. This is a function of lower yields on a slightly higher area. We do not see any expansion of area during planting. In fact regarding the availability of water, even though we have had a normal monsoon in this quarter, the availability of water starting from January end up to May seems to be on a lower side. Farmers are being very cautious in replanting. I think as I said before, Renuka would not like to take a view on the next crop until the 31st of March which is when the planting goes.

Just to summarize my reply in terms of pure economics, cane continues to be the best crop in Maharashtra followed by soya bean and cotton. There is a decent gap between cane and other crops. But on the water availability and the yield side there is starting to be an issue and we have to see how that affects the planting for the next season.

Arya Sen

Can you also brief us about the sale of the Cogen unit in Brazil? What is the kind of valuation you are looking at and what sort of cash flow you expect from that and which part are you selling over there?

Narendra Murkumbi

Well I do not want to say too much because these discussions are at an advanced stage with a short list of the bidders. What we have put up for sale is about 138 MW of operating commissioned capacity. Obviously, when we do have a firm deal with someone we will come out with the full disclosure.

Arya Sen

Can you also give the consolidated debt figures at the end of the quarter?

Narendra Murkumbi

I think we are about 700 Crores more than we were on 30th September.

Arya Sen

At the consolidated level?

Narendra Murkumbi

Yes.

Arya Sen

Thanks a lot Sir. That is all.

Moderator

Thank you. We have the next question from the line of Girish Achhipalia from Morgan Stanley. Please go ahead.

Girish Achhipalia

Firstly on the Capex side, what are your expectations for fiscal 2013 now in terms of hectares of replanting cane that would come-in and on the industrial side if you have any plans? The second question is on interest cost. Q-o-Q, the Brazilian interest cost seems to have gone down and your debt you said is marginally down. So, if you can share what exactly happened because INR number seems to be down? Thirdly is on the refining margins. Now that you are taking domestic raw sugar, are you expecting, over the next two quarters or three quarters, better margins? What is your visibility on it? Thank you.

Gautam Watve

Girish, I will answer the first two questions and then I will pass on the refining question to Mr. Murkumbi. On the interest side, which you rightly pointed out, the base PLR rate in Brazil which is CDI has gone down by 2% over this quarter. It is now 10.5% from 12.5% earlier. So that is why the interest has gone down. In terms of planting, we are looking at a total planting plan of 40,000 hectares, half of which will come from suppliers and half of it from our own resources. In Brazil, the BNDES, which is a national developmental bank, has actually come out with a scheme which gives loans for planting at an interest rate of about 7.2% payable over 6 years and we plan to apply in that scheme as well.

Girish Achhipalia

These 40,000 hectares that you spoke about would be basically fresh so there would be about one-sixth on replanting and anything on the industrial side?

Gautam Watve

Out of the planting that we are talking about 10,000 ha is renewal whereas 30,000 ha is new.

Girish Achhipalia

Anything on the industrial side?

Gautam Watve

No. Nothing on the industrial side.

Narendra Murkumbi

On the refining, I think we are currently seeing EBIDTA of about $60/tonne. As I said, we have visibility for this quarter and the next quarter and so we expect to run at an average of 3,000 tonnes per day versus our total capacity about 5,000 tonnes per day. Our margins are higher in Kandla so we are currently running Kandla at close to full capacity. Currently, it is running smoothly between 2,500 to 3,000 tonnes per day.

Girish Achhipalia

A follow up on one of the things that I saw in the press about Lanco CEO joining the group. What are the plans on Shree Renuka energy front? Is there anything planned out there?

Narendra Murkumbi

I do not really want to talk about it in Renuka Sugars call. That is a separate company.

Girish Achhipalia

Thank you, Sir.

Moderator

Thank you. We have the next question from the line of Anup Randiv from Derivium Tradition. Please go ahead.

Anup Randiv

Thank you for the opportunity. My question is to Mr. Kumbhat. Sir, could you share the absolute debt number that we have in Brazil and how much of the total debt do we have in USD and average interest cost?

Gautam Watve

The debt on the Brazilian side is roughly the same as the last quarter. It is there in the disclosures and the rate of interest is about 7.5%.

Anup Randiv

Is that in Brazil or the total?

Gautam Watve

Those are the Brazilian numbers.

Anup Randiv

What is the average interest cost for consol debt?

Narendra Murkumbi

In Brazil, as we have said, the total weighted average interest cost for the Dollar and Real loans is about now 7.5% consequent to the drop of the domestic interest rates.

Anup Randiv

Could you share the USD denominated debt?

Gautam Watve

Anup, we have released a presentation in January about our Brazilian operations. It has details about the debt.

Anup Randiv

I will refer to that. Thank you.

Moderator

Thank you.

Narendra Murkumbi

We will have the last question please.

Moderator

Alright. The next question is from the line of Mr. Varun Guntupalli from Edelweiss Securities. Please go ahead.

Varun Guntupalli

Good evening, Sir. My question is pertaining to the additional stake which we were acquiring in RDB. So are we done with that and right now what is our current stake in the company?

Narendra Murkumbi

We have put in the additional money that was agreed as part of the JVA and today our stake is 59.4%.

Varun Guntupalli

So it is like we do not have any further plans from here on? Now as we have done with the additional acquisition and it will stay here for sometime 59.4%, right?

Narendra Murkumbi

Yes that is correct.

Varun Guntupalli

Okay that is all I have Sir. Thank you.

Narendra Murkumbi

Thank you friends for dialling in to our call and for all the questions. Our investor relations team headed by Vishesh Kathuria is available any time for follow-up questions. We have also taken your feedback from last time and we have put out more information, especially on our Brazilian business. The next quarter is also going to be the quarter for our annual results and at that time you can expect us to share significantly more information on both the Indian and the Brazilian business. I thank you again for your interest and confidence in our company. Good evening.

Moderator

Thank you. On behalf of Shree Renuka Sugars Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.

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For further information on Shree Renuka Sugars visit www.renukasugars.com

Safe Harbour

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