



Aditya Birla Nuvo Limited

Transcript of Q1FY11 earnings call
held on July 30, 2010

MANAGEMENT TEAM: MR. SUSHIL AGARWAL – CFO, ADITYA BIRLA NUVO
MR. PANKAJ RAZDAN - DEPUTY CEO, ADITYA BIRLA FINANCIAL SERVICES
MR. DEEPAK PATEL- CEO, BPO AND IT SERVICES
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Moderator: Ladies and gentlemen, good afternoon, and welcome to the Aditya Birla Nuvo conference call. We have the senior management of the company with us. As a reminder, for the duration of this conference, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need any assistance during the conference, please signal an operator by pressing "*" and then "0" on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Sushil Agarwal who is the CFO of Aditya Birla Nuvo. Thank you, and over to you Mr. Agarwal.

Sushil Agarwal: Good afternoon everybody. A very warm welcome to all of you. I will briefly touch upon the company's key highlights and financial performance for Q1. Let's look at ABNL's macro picture for Q1FY11 on slide 4. The company has been showing consistent earnings growth over last few quarters. During the first quarter, our consolidated Revenue registered growth of 18% at nearly ₹ 3850 Crore. EBITDA is up by 66% at ₹ 556 Crore. Our Net profit at ₹ 149 Crore has significantly improved vis-a-vis net loss of ₹ 35 Crore last year. The growth continues to be supported by a strong balance sheet with net debt to EBITDA at less than 4 and net debt to Equity at less than 1. Considering Aditya Birla Nuvo's business and revenue mix with strategic investment of about ₹ 5300 Crore these ratios are at reasonable levels.

All our businesses have shown increase in the revenue. In the IT-ITeS business revenue de-growth has been arrested and going forward we are confident to achieve growth backed by strong order book. All our businesses have shown growth in EBITDA. In the Telecom business too, EBITDA was sustained despite competitive pressure on tariffs and launch of new service areas.

Coming to business wise performance, I will start with financial services. As you know, vision of Aditya Birla Financial Services (ABFS) is to be leader and role model with a broad-based and integrated business. In line



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with the vision, our combined assets under management grew by 19% to reach about ₹ 83,600 Crore. Our revenue is up by 23% at about ₹ 1280 Crore. ABFS achieved net profit of ₹ 54 Crore during this quarter against loss in the corresponding quarter of the previous year.

In the life insurance sector, the new IRDA guidelines have brought much awaited clarity for the sector. The fundamentals of the industry remain unchanged and sector opportunity continues to remain attractive in the medium to long term. However, in the short term life insurance will have to go through a transition phase and relook at its operating model. Amidst these challenges, Birla Sun Life Insurance is driving efficiencies across its distribution channel and operations to achieve sustainable profitable growth. In the direction of expanding non ULIP portfolio, BSLI launched Bachat, an endowment plan which is garnering positive response. Total premium income is up by 18% to about ₹ 1150 Crore driven by strong renewals growth. Expanding in-force book size is reflecting in bottom line with net profit of ₹ 9 Crore vis a vis net loss of more than ₹ 100 Crore in Q1 of last year. Accordingly there was no capital infusion requirement during the quarter. Birla Sun Life continues to grow profitably in terms of Embedded Value and Value of new business. As on 31st March 2010, EV at about ₹ 3,800 Crore has grown by 25% over last year. VNB margin has increased from 20.3% in 2008-09 to 22.5% in 2009-10.

Coming to Asset Management business, Birla Sun Life AMC is laying thrust on increasing share of Equity and alternate assets. During the quarter, while Industry AUM remained flat year on year, BSAMC grew by 12%. It achieved highest year on year and quarter on quarter growth amongst top 5 players and ranked No. 5th with an improved market share at 9.3%. Its Equity AUM is now around ₹ 14,000 Crore up by 42%. It ranked amongst top 3 equity mobilizers, garnering equity net sales of ₹ 425 Crore compared to net redemption in the Industry. Recently it also launched Real Estate Onshore Fund in line with our focus on increasing share of alternate asset class. Its revenue more than doubled to ₹ 100 Crore and net profit grew multifold to ₹ 32 Crore.



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In telecom, Idea Cellular's endeavor is to build sustainable competitiveness while maintaining growth momentum. It ranks 3rd in terms of revenue market share. Its revenue grew by 23%. Despite 24% decline in average realized rate in past 5 quarters and even after absorbing launch in seven new service areas, Idea has sustained its cash profits. This was supported by a robust growth in minutes of usage and reduction in cost per minute. Idea has won 3G spectrum in 11 services areas which contribute 80% of its existing revenue. 3G Footprint of Idea covers all 8 service areas where Idea ranks 1st, 2nd or 3rd. The reported quarter witnessed lowest fall in ARPU in the past six quarters, which seems to be a positive sign for the industry. With the peak losses of new launches behind it, Idea is well positioned to emerge stronger.

In the IT & ITeS business, our focus is on augmenting capabilities and building strong order book with focus on bottom line. Accordingly Aditya Birla Minacs acquired 'Bureau of Collection Recovery' which is a leading US based accounts and receivables management company. This is Minacs 2nd acquisition after Compass to augment customer lifecycle portfolio and improve non voice business mix. During the quarter, Minacs arrested de-growth in revenue. Aditya Birla Minacs is targeting top-line growth in coming quarters on the back of strong order book. During the quarter itself, it has built an order book of USD 134 million. It's consistently improving profitability is reflected in EBITDA numbers and margins. It posted net profit of ₹ 10 Crore vis-a-vis net loss of ₹ 8 Crore in corresponding quarter of the previous year.

In Fashion and Lifestyle business, our focus is on capitalizing on brand leadership and improving channel productivity to achieve profitable growth. As a result our revenue grew by 37% to about ₹ 350 Crore led by 38% volumes growth. Retail channel achieved 30% like to like sales growth. Profitability improved considerably with EBITDA at ₹ 19 Crore on the back of better margins and lower discounting. We also launched 33 exclusive brand outlets to reach total of 425 EBOs.



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In the Manufacturing businesses, we stayed focused on capturing sector growth and realizing full potential. Combined together our manufacturing businesses have achieved revenue growth of 23% at ₹ 970 Crore and EBITDA growth of 37% at ₹ 172 Crore. Both operating margins and Return on average capital employed further improved to 18% and 25 % respectively.

Let's now look at Financial Performance.

Growth in consolidated revenue was led by financial services, most of which has come from the life insurance. In the Telecom business, decline in realised rate per minute was more than compensated by a robust growth in total minutes of usage. In the IT-ITeS business, we are confident that the strong order book and sales pipeline built will benefit going forward. Robust Like to like store growth and improved footfalls contributed to Revenue growth in the Fashion & Lifestyle business. Almost all the manufacturing businesses achieved good volume growth. On a consolidated basis, revenue grew by 18% to about ₹ 3850 Crore. If we look at consolidated revenue mix, financial services business is the largest contributor followed by telecom.

The EBIT has grown more than 3 times from ₹ 89 Crore to ₹ 307 Crore led by Financial services followed by Fashion & Lifestyle and Manufacturing businesses. Profitability in the Telecom business at EBIT level was lower due to margin pressure. Robust sales growth augmented profitability in the Fashion & Lifestyle business. Thrust on cost rationalization efforts drove bottom-line improvement in the IT-ITeS business. Manufacturing businesses posted strong growth in earnings led by Carbon black and Agri-business.

Net profit posted a swing of ₹ 185 Crore. The largest contribution to the net profit growth has come from operations. Interest expenses decreased led by repayment of loans and working capital rationalization in the manufacturing businesses. Depreciation grew largely due to expansion in the Telecom business. As a result, the company posted a net profit of ₹



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149 Crore compared to net loss of ₹ 35 Crore incurred in the previous year.

With this I conclude. Along with me, I have Mr. Pankaj Razdan, deputy CEO of Aditya Birla Financial Services, Mr. Deepak Patel, CEO for IT-ITeS business and Manoj Kedia, deputy CFO of Aditya Birla Nuvo. We can now proceed for Q&A session.

Moderator: Thank you, sir. Ladies and gentlemen, we will now begin with the question and answer session. At this time if you would like to ask a question, please press "*" then "1" on your touchtone telephone. If you decide you want to withdraw your question from the questioning queue, please press "*" then "2". Participants are requested to use only handsets while asking a question. Our first question comes from the line of Nikunj Doshi from Bay Capital. Please go ahead.

Nikunj Doshi: I just wanted to understand; we have been talking of value unlocking from the finance business vertical, how far have we reached and what is the game plan going forward? Is there any event, which can be expected in the near term?

Sushil Agarwal: Nikunj, you are right, we have been talking about creation of a financial services holding company. If you recall, we have multiple regulators involved in this process including IRDA, SEBI and RBI. We have been talking to all of them to get the approval. We have got the RBI approval and are in close discussion with other regulators and hopefully sooner than later we should get approval. Meanwhile, we are keeping the ground work ready.

Nikunj Doshi: Okay. On the life insurance business, there are expectations that NBAP margin, which is around 20 odd percent for the industry could come down to a low single digit or it may even result into a loss. What is your take on that because of the change in regulations?



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Sushil Agarwal: I will take up this answer and may be Pankaj can add to it. You know, fundamentally the long-term view about the industry has not changed at all but the way regulations have changed, all the industry players are reviewing their operating models to make them more centered around the customer. This could mean that as ULIPs will evolve to be more transparent offering competitive returns, we may even see an upside potential leading to possibly higher volume growth. As we know, customers would now be able to effectively meet their investment return as well as protection needs even over a relatively shorter horizon going forward on these products.

Pankaj Razdan: I would like to add that while it is too early to comment on each of the specific areas, what we can share is that we are working to ensure that we protect our margins. So, if necessary we will have to tweak our business models and work towards achieving a more balanced product mix. This would obviously mean that we relook at our operating model from the start of the value chain to the end of the value chain, which includes distribution, back office, and the way we do our business. So, I believe that the endeavor still would always be to protect our margins. But at the same time, we will continue to do for the growth what we have been doing given the long-term attractiveness of insurance business.

Moderator: Thank you. Our next question comes from the line of Nillai Shah from Morgan Stanley. Please go ahead.

Nillai Shah: The question is on persistency for the fiscal '09-10. Can you give me the persistency levels?

Sushil Agarwal: We have around 85% of persistency on 13-month basis. This is also disclosed on the website of Birla Sun Life Insurance.

Nillai Shah: Okay. The capital employed in the textile business is down dramatically. Any reason for that?



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Sushil Agarwal: There has been significant working capital reduction due to better credit terms. As a result there has been a reduction of capital employed.

Nillai Shah: The focus on that business continues, right?

Sushil Agarwal: Definitely yes. Though Nuvo is a conglomerate but each business has a separate focus and is managed by a business head. Profitable growth is our focus across the businesses. With the rationalized capital employed, the textiles business has improved its ROACE considerably.

Nillai Shah: In terms of garments, what has resulted in this sharp growth in the profitability?

Sushil Agarwal: As I said, there are a couple of things, which has happened in the garment business. We had a 38% volume growth. We achieved a 30% like-to-like growth from our retail channel. Improved footfalls and a good marriage season supported this growth. Again, the cost rationalization efforts, which we have been pursuing since few quarters, those efforts are also paying back.

Nillai Shah: Any guidance for full year insurance profitability?

Sushil Agarwal: You know, as these regulatory changes have been announced towards the end of June 2010, we will not be able to give much guidance on the specific initiatives that we have been planning. However, we are working on our product strategy & the operating model that we as an organization will be moving towards. Therefore, we will have to come back to you on this, which I believe will be sooner than later, once we have a specific plan to share with you.

Nillai Shah: Okay. In the month of June and July is there any indication of how the new business premiums have moved?

Sushil Agarwal: While we registered 7% growth in new business in Q1, it will be relatively early for us to comment on July numbers. The Q1 business numbers are in line with our expectations given the challenging regulatory



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environments and our focus on improving the quality of business & increasing the share of traditional products to the total new business. However, it is natural that during periods where regulatory changes have been announced, the momentum is likely to get impacted.

- Nillai Shah:** Is it a growth or decline?
- Sushil Agarwal:** For the month of July 2010, it will be a forward looking comment and the month is not over yet. And as I said when you have regulatory changes, it will tend to have some impact on the business.
- Pankaj Razdan:** I will just add that, our growth in the month of June 2010 was 13% compared to last year-on-year basis.
- Nillai Shah:** It is very helpful. Thank you.
- Moderator:** Thank you Mr. Shah. Our next question comes from the line of Rajiv Verma from Merrill Lynch. Please go ahead.
- Rajiv Verma:** Your VNB margin has actually expanded. Is it possible to get an idea of the margin on a completely blended basis because I guess this is for the individual business, right? The 22.5% that you have reported?
- Manoj Kedia** Yes, that is on individual basis only. The industry norms have been to report margins only for individual business. This practice is followed by all the players across the industry as both are treated as separate lines of business Moreover, in group business the margins are minimal, and hence including it in margin calculation will not give the true picture of profitability of new business.
- Rajiv Verma:** What is really helping you to expand margin because at the sector level we are seeing margin compression coming through and what percentage of your incremental premium is coming from unit linked policies?
- Manoj Kedia:** Margins have gone up as a result of our continued focus on writing long-term quality business and offering higher sum assured products. With



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regards to the 2nd question, the Bachat endowment product, which we had launched in May 2010 on traditional platform, has been garnering an encouraging response. In Q1FY11, more than 25% of policies sold are contributed by our traditional product range. We are working towards launching few more traditional products and increase their share in new business.

Rajiv Verma: Okay, but ULIP would be still like 75% to 80%?

Manoj Kedia: Yes, largely it is ULIP driven as of now.

Rajiv Verma: On your embedded values the cost overruns that you have mentioned, it seems to be coming down, how was it last year in fiscal '09?

Manoj Kedia: We have assumed that the expense overruns should be eliminated, I believe, within the next two years' time i.e. by FY12-13. As per our latest business plan, the expense allowances are projected to be 95% of the planned operating Expenses in FY 2012-13.

Rajiv Verma: Okay. What is the kind of estimation are you targeting on your capital infusion may be over the next couple of years?

Sushil Agarwal: Actually Rajiv, if you would recall, based on the present business plan for the current year, we have assumed that there would be an infusion of around ₹ 200 Crore capital for FY11. Nuvo would contribute 74% out of that. This is based on the latest business plan and these projections do not consider the recent regulatory changes. Hence, we will have to revisit our plans and review our capital requirement as a result of the impact of the new regulations.

Moderator: Thank you. Our next question comes from the line of Vivek Doval from Boyer Allen. Please go ahead.

Vivek Doval: I wanted to understand the proposal by the IRDA. Are they just proposals at this stage or are they actual regulations. Is there a deliberation process with the industry or has that already happened for the fact these



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proposals have already come up, so that is one. Second, for insurance business, given the fact that it is profitable in the quarter, has it turned profitable on ongoing basis or there could be volatility in the quarters.

Pankaj Razdan: For the 1st question, IRDA has come out with final regulations and we have been given a deadline of 1st September to implement these changes. And on the 2nd part of the question, the profits have been contributed largely due to the growing inforce business and hence, these profits will continue to accrue going forward as well. However, profits are also a function of the growth in new business and we also expect a transitional impact of around 3-6 months as we implement certain changes in areas of product and distribution.

Moderator: Thank you. Our next question comes from the line of Raunak Agarwal from RBS. Please go ahead.

Raunak Agarwal: What will be the difference in reported EV if we do it by the MCEV approach, as HDFC Standard Life has done? What will be the key reasons for the variance?

Pankaj Razdan: We have not been calculating our embedded values as per MCEV methodology. Hence, we will not be able to provide with any specific guidance on what our numbers would have looked like under MCEV methodology.

Raunak Agarwal: Theoretically speaking, what is the main difference between the two and will there be a material difference in the amount?

Pankaj Razdan: As you would know that there is no difference in terms of non-economic assumptions that are being used for both the methods. However, MCEV methodology would ideally mean using different levels of discount rates. At this point, what we can directionally share with you all is that, if we would have reported EV as per MCEV methodology, we would have reported a higher value given that our inforce book consists primarily of unit-linked business.



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Moderator: Thank you. Our next question is a followup from the line of Nillai Shah from Morgan Stanley. Please go ahead.

Nillai Shah: Just two quick questions on the embedded value. One is basically going forward after the IRDA regulations, what do you see as the expenses going forward? Because I believe the expenses would spike up because of the new regulations coming in. Secondly, IRDA has also said that the commissions payable to the agents and all the other expenses have to be spread out over the next five years, that is the locking period for the ULIP, a few companies are thinking about paying them upfront and then monetizing them. What is your take on that?

Pankaj Razdan: Embedded Value is not going to be impacted because the cost is already factored in the calculation of embedded value through reduction of Adjusted Net worth. What is going to impact depending upon how the regulations pan out & how each of the business models get adjusted, will be the new business margins. I will not be able to provide specific pointers on how commission and other expenses for the distributors would work out. But as I have said at the outset, our efforts will be to tweak our business model and to focus on optimizing the cost structure and focus on building efficiencies to ensure that we start protecting our growth and margins. Clearly, the new regulation would mean that the entire process needs to be accelerated.

Moderator: Thank you. Our next question comes from the line of Kuldeep Khanapurkar from Kotak Mahindra. Please go ahead.

Kuldeep K: I have three questions for life insurance business. One, your EV, as you said in the presentation is before considering the new ULIP guidelines. Could you give us some sense in terms of what change in EV you might have if you consider these ULIP changes? Second, your FY'10 Sun Life Insurance expense ratio is around 24%. What expense ratio you have built in while calculating EV and what steps are you taking to reduce the expense ratio to a slightly lower number? The third is, your persistency is 62%, if I am not wrong, for FY'10, what are the steps you have taken last



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year to increase this persistency because FY'09 to FY'10 there has not been a great improvement?

Sushil Agarwal: I think Pankaj has already covered the 1st question on EV. As he has correctly pointed out that embedded value is as of March 2010 for existing business only. And as such, existing business value will not get impacted as a result of the new regulations that are to be effective from 1st September 2010. To answer your 2nd Question, the bulk of the expenses i.e. acquisition expenses have already been factored in arriving at the embedded value. On your 3rd Question, you are perhaps referring to the conservation ratio which has seen an improvement in Q1FY11 and has reached 75%. We had always maintained that the fall in conservation ratio was a temporary phenomenon due to premium reduction features of earlier products which was to go away from the current year onwards. Also, it will also be worthwhile to note that the correct measure to look at will be our 13-month persistency on an inforce basis that continues to be at around 85%.

Kuldeep K: You have 24% expense ratio, so are you comfortable with the number? What is the expense ratio we assume while calculating the EV?

Manoj Kedia: Our expense ratios and overruns have been showing a declining trend and we are quite comfortable with it. Directionally, we are also committed that our expense overruns would be eliminated by financial year '12-'13 and we will be taking appropriate measures to achieve that. As Pankaj had earlier mentioned, the recent regulation has necessitated that we go to the drawing board and revisit our operating model that will help us protect our growth and margins going forward.

Kuldeep K: So this will come from the cut in the cost or improving the efficiency or productivity?

Sushil Agarwal: I think it would be combination of all the things; until we come back with this final business plan on this, it would be a little premature for us to comment on the specific initiatives and priorities.



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Moderator: Thank you. Our next question comes from the line of Avinash Agarwal from Sundaram BNP Paribas. Please go ahead.

Avinash Agarwal: I wanted to understand how the industry is going to react in terms of the commissions. Do we see the commissions coming down? IRDA had also brought out recommendation of commissions of agents meeting 50% of their renewable targets, if they have not met, then they have to return the commissions, what is your view on that?

Pankaj Razdan: I think, in terms of the commissions, as I have said that these regulations are very transparent. And so, obviously the whole proposal is to go and make it a very cost-effective proposition for customer. As insurers will need to have a re-look at their business and distribution models, this will also include aligning the commission structures. It also depends upon how your business model is, like in our case, 75% of the business comes from top 30% to 35% distributors. Our endeavor will be to protect the right pool of our distributors and provide a value proposition for them. That is for your 1st question. For the 2nd question, on the Agent persistency requirements, the proposed regulation is currently in a draft stage and still being discussed and it has yet not become a regulation. I think we will have to wait and watch till the time it comes and in what form and shape it will come out.

Avinash Agarwal: Okay. Do you see a high cost model like corporate insurance agents, etc., being affected due to this regulation, and more cost effective ones like bank assurance gaining because of these regulations?

Pankaj Razdan: As I said, everybody is trying to make their business models more effective and efficient. Although, certain channels may initially look like high-cost models we may see a change in the customer segmentation. As you have rightly said, like a broker may have to look at very different segmentation and different lines of products. It is a little early for us to comment on the specifics, but what I am saying is that not only the industry players but also the distributors will be working towards ensuring that that the growth and margins are maintained. Obviously, banks would



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have some initial advantage because they have a common infrastructure and a customer base. But nevertheless, I believe that everybody else is tweaking their models to have the growth in place.

Avinash Agarwal: You mentioned that it is a little early to guess, but to what extent do you think the NBAP margins could be affected on the new policies, just to give us an idea.

Pankaj Razdan: The impact of margins can largely be insulated by focusing on a balanced product portfolio, achieving higher efficiencies and tweaking our business model from end to end in the value chain whether it needs tweaking in our distribution, product or infrastructure. As we are still evaluating and prioritizing on the initiatives, it would be unfair to further comment on that.

Moderator: Thank you. Our next question comes from the line of Aditya Srinath from Quantum Asset Management. Please go ahead.

Atul: I have one question related on the debt side, are we looking at some further reductions from the current level?

Sushil Agarwal: If you see quarter after quarter, there has been a reduction in our debt level, and with a healthy cash flow coming up from the operations, we will be reducing our debt level for sure.

Atul: Any new plans for any further infusion or something like that to reduce this drastically in the near term?

Sushil Agarwal: If you look at our manufacturing businesses, they combined together generate around USD 125 Million cash from operations on an annual basis. Balance promoter infusion of USD 100 million will further support. Capital requirement of life insurance business has reduced considerably. So these kinds of cash inflows could easily be used to repay some of our existing loans, so in normal course definitely there seems to be a reduction in existing borrowing.



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Atul: On the manufacturing side or on the stand-alone side, what kind of amount of CapEx we are looking in the current year?

Sushil Agarwal: In the current year we have a total CapEx plan of around ₹ 300 Crore, out of which ₹ 150 Crore is towards maintenance capex.

Atul: On the garment side we have some kind of improvement in the margin and historically we used to do close to about 5% to 6% kind of margin, do you see any of that happening by the end of this year?

Sushil Agarwal: If you recall, there has been cost rationalization efforts which has been ongoing in the garment business, which is actually paying results now. There has been considerable improvement in working capital requirements also. In this quarter, we had seen a 30% growth on like-to-like basis. We had seen 38% volume growth. So all these things put together has given us this kind of result. Going forward also, we are expecting growth, sustaining the margins.

Atul: What will be the current area income per square feet and what you are looking by expanding in the next couple of year's time?

Sushil Agarwal: We presently have around close to 8.5 Lakhs square feet and as I said during the current quarter we have added around 33 exclusive outlets, which has totaled up to 425 outlets for the company, and in addition to that we have around 1000 odd different franchisees outlets where these things are being sold presently. I just want to add that, all these new outlets, which we have opened, these are all broadly on franchisees model.

Moderator: Thank you. Our next question is a followup from the line of Vivek Doval from Boyer Allen. Please go ahead.

Vivek Doval: In terms of the thought process regarding your potential listing of the financial services business or of the insurance business on a stand-alone basis, do you have any better clarity on the timelines for that?



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Sushil Agarwal: Vivek, as responded earlier, we are in constant discussion with these regulators. I think we can't share any timelines or further details in this regard.

Moderator: Thank you. Our next question comes from the line of Amit Rathi from CRISIL. Please go ahead.

Amit Rathi: Just a house-keeping question. What level of ramp up are you expecting at Patalganga unit, by the end of this fiscal what will be the volume?

Sushil Agarwal: We are expecting 100% capacity utilization from Patalganga by the end of this calendar year.

Amit Rathi: What was it this quarter, Q1?

Sushil Agarwal: In Q1 it was under stabilization.

Moderator: Thank you. As there are no further questions, I would like to hand the floor back to Mr. Agarwal for closing comments.

Sushil Agarwal: Thank you everybody. Pankaj, Deepak and Manoj thanks for joining this call. Thanks very much.

Moderator: Thank you sir. In case of any investor query, please contact Mr. Romi Talwar or Mr. Saket Sah. On behalf of Aditya Birla Nuvo that concludes this conference call. Thank you for joining us and you may now disconnect your lines. Thank you.