Aditya Birla Nuvo Ltd.

Transcript of Q2FY13 earnings call held on 8th November 2012

Management Team:

- Mr. Sushil Agarwal – Whole time Director & CFO, ABNL
- Senior Management Team, Aditya Birla Financial Services
- Mr. Ashish Dikshit, CEO, Madura Fashion & Lifestyle
- Mr. S. Visvanathan, CFO, Madura Fashion & Lifestyle
- Mr. Ramesh Kamath, CFO, IT-ITeS business

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Moderator Ladies and gentlemen good day and welcome to the second quarter earnings conference call of Aditya Birla Nuvo. As a remainder, 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 assistance during this conference call, please signal an operator by pressing '*' followed by '0' on your touchtone phone. Please note that this conference is being recorded. At this time I would like to hand over the conference to Mr. Sushil Agarwal, the Whole Time Director and CFO of the Company. Thank you and over to you.

Sushil Agarwal Good evening. With me I have senior management team of financial services. Ashish Dikshit – CEO and S. Visvanathan – CFO of Madura Fashion & Lifestyle. We also have Ramesh Kamath, CFO of the IT-ITeS business.

I will quickly take you through the key highlights of the quarter.

Starting with the financial services business. Aditya Birla Financial Services has posted a strong growth in profitability and assets size across its businesses. Combined funds under management has crossed ₹ 1 lakh Crore mark. However growth challenge still persists in the sector, as a result of which top line de-grew year on year by 12% mainly on account of de-growth in the Life Insurance business. ABFS has gained market share in the Asset Management and Broking businesses. Its earnings before tax rose by 39% - contributed by all the businesses. Lending book size of NBFC business more than doubled in past one year and crossed ₹ 5,000 Crore mark.

In the telecom business, Idea's market share grew by 100 bps in past one year to 14.9%. Led by a strong 18% growth in minutes of use coupled with rising revenue share and cost optimization, Idea achieved sound earnings growth.

In the Fashion & Lifestyle business, lower customer footfalls and spending continues to constrain the growth of the sector. Revenue growth of Madura has also been moderated to 9%, but it was largely due to wholesale channel. The growth in the retail channel was quite impressive at 21%. This growth was supported by retail space expansion and like-to like stores sales growth.

In the IT-ITeS business, order book written and capacity added in the previous years is reflecting in the profitable growth. Favourable forex movement has also contributed.

The Manufacturing businesses have posted growth in profitability, despite constrained earnings in the Carbon Black and Insulators businesses. The VFY capacity expansion using spool technology of ENKA, Germany is likely to complete in the fourth quarter.

Reflecting the strength of its conglomerate model, earnings of the Company touched some new highs. During the quarter, revenue of the Company almost touched ₹ 6,000 Crore mark. EBITDA crossed ₹ 1,000 Crore mark growing year on year by 30%. And Net Profit crossed ₹ 300 Crore mark growing year on year by 42%. Barring a few, all the businesses contributed to the earnings growth. Quarterly revenue has almost doubled in three years times while EBITDA has grown almost 3 times.

Net Debt to EBITDA as on 30th September 2012 improved quarter on quarter. Improvement in annualised Standalone EBITDA and receipt of ₹ 425 Crore subsidy in July 2012 contributed.

Coming to business wise performance. Financial Services sector's growth remains under pressure, particularly in the life insurance industry. Top-line of Aditya Birla Financial Services has de-grown on account of this. However, its profitability and assets size has expanded and market share grown. Market share of the Asset Management business has grown year on year from 9% to 9.8%. Aditya Birla Money has also increased its market share in the equity broking as well as commodity broking segments. Assets size of Life Insurance and Asset management businesses achieved strong growth year on year as well sequentially. Lending book size of NBFC business more than doubled year on year to ₹ 5,150 Crore. Combined Earnings before tax at ₹ 193 Crore surged year on year by 39%. While Life Insurance and Asset Management businesses are generating cash surplus, NBFC business requires growth capital. A sum of ₹ 100 Crore was infused in July taking the net worth of NBFC business to ₹ 769 Crore. Among other initiatives, Aditya Birla Money MyUniverse, the online money management platform launched by ABFS, has acquired more than 50,000 customers during the first quarter of launch. ABFS has acquired an additional 1% stake in Birla Sun Life Asset Management taking its holding to 51%.

Led by a strong 18% year on year growth in minutes of use, Idea's revenue rose by 15% to ₹ 5,307 Crore. EBITDA margin expanded by more than 100 bps led by optimization of subscriber acquisition and business promotion costs. EBITDA surged by 20% to ₹ 1,434 Crore. Net profit more than doubled to ₹ 240 Crore. Forex gain and interest cost savings also contributed. Its strong balance sheet and free cash flow generation continues to support company's growth plans. Since past 5 quarters Idea has been free cash flow positive. Indus Towers paid its maiden dividend. A dividend of ₹ 154 Crore was received by subsidiary of Idea.

Driven by continuous scaling up of exclusive brand outlets and like-to-like stores sales growth, Madura's revenue from the retail channel grew year on year by 21%. Retail channel stands expanded to 1,197 EBOs spanning across 1.7 million square feet. Overall revenue growth was moderated to 9% due to muted growth in the wholesale channel. However, Madura registered a strong 13% growth in EBITDA at ₹ 65 Crore. Sales growth and improved gross margin contributed to the growth in profitability. Business continues to generate sound ROCE.

Updating on the Pantaloons transaction. Post approval by the stock exchanges, the demerger scheme has been filed with the Hon'ble Bombay High Court. In its hearing, the Hon'ble High Court has directed Pantaloon Retail India Limited to hold its shareholders' meeting on 6th December 2012. An application has also been filed with the Competition Commission of India for its approval. Pantaloons Retail India Limited, through a court scheme of arrangement, will transfer 'Pantaloons Fashion Format' to Peter England Fashions & Retail Limited or the resulting company, which is currently a 100% subsidiary of ABNL. Post demerger, the holding of ABNL, through its subsidiary, in the resulting company, will be 50.09%. On effectiveness of the Scheme, the equity shares of the resulting company will be listed on the NSE and BSE.

In the IT - ITeS business, revenue of Aditya Birla Minacs scaled up year on year by 31% and EBITDA soared by 51%. A major part of earnings growth is coming from conversion of order book and improved gross margin while favourable forex movement also contributed. In constant currency terms as well, revenue grew by 13% and EBITDA by 33% during the half year. The business continues to generate steady cash profit to fund its capex and working capital requirements.

In the Manufacturing businesses, the revenue rose year on year by 33% and EBITDA by 4%. Despite cheaper Chinese imports which continued to constrain sales volume and profitability in the Carbon Black and Insulators businesses. Higher urea sales and growth in revenue from trading of imported fertilisers added to top-line as well as bottom-line. Volume growth and improved realisation in the Rayon business and linen segment of the textiles business also contributed.

Going forward, ABNL will continue to pursue strategic objectives across its businesses. In Life Insurance business, augmenting product offerings will be prime focus area. Asset Management business is targeting growth in assets size. NBFC business will continue to scale up its book size cautiously Idea is committed towards gaining revenue market share and participating in evolving wireless broadband business. Fashion & Lifestyle business will continue to leverage its brands and retail channel. Besides maintaining revenue growth, IT-ITeS business will focus on operational efficiencies to improve margins. Enhancing cost competitiveness and improving margins will be key in the Manufacturing businesses.

To summarise, due to sluggish economic environment, earnings or growth pressure exist in some of the businesses. However, most of the businesses are contributing to the profitable growth and are competitively well positioned. On balance sheet front, leveraging ratios appear on a higher side. We are hopeful that eventually these ratios will be back in the comfortable zone. The balance promoter infusion will also further support the balance sheet. With this I come to the end of my presentation. We can now open session for questions and answers. Thank you.

Moderator Thank you. Participants, we will now begin with the question and answer session. We have the first question from the line of Priya Rohira from Axis Capital. Please go ahead.

Priya Rohira My first question relates to the fashion and lifestyle business. If you could help us on the business outlook in the coming quarters, how do you see this based on the consumer behaviour? And the second thing is if you could throw more light on the working capital and long term ROCE target which you are looking in the business?

Ashish Dikshit As you have noticed, our Q2 revenue has grown by about 9% which is similar to what we have grown in Q1 itself. Going forward, based on the current sentiments and the traction that we are beginning to see at this point, we believe that Q3 and Q4 would be in excess of 15%. It is difficult to estimate beyond that at this stage, because we have just come off almost a year of reasonably tepid growth. But from all indications that we have had of the festival purchases in past month or so, it appears that the revenue uptake will be much higher than what we have seen in the first half this year. Question on return on capital employed, as you had seen in the presentation, return on average capital employed is 17% in H1. In this industry H2 is the heavier part of the business where revenue, like to like growth, the retail productivity etc are typically much higher, as well as the wholesale channel growth is higher because of the larger number of festivals and winter season in H2. On annual basis, we expect ROCE to be in the range of 20% to 25%. Going forward as we leverage our retail, this will only enhance from here.

Priya Rohira Is it possible for you to share the ROCE specifically in retail and wholesale separately?

Ashish Dikshit We do not separately track that, because some of the capital is actually utilised right across. There is only a part of the capital which goes exclusively for retail stores. In fact large numbers of stores are through franchise capital invested. And therefore the company capital, significant part is actually done for the business as a whole and therefore we do not calculate RoCE separately for retail and wholesale.

Sushil Agarwal Just to add what Ashish was saying. For the 2nd quarter, our ROCE in the Fashion & Lifestyle business was 30%. Since in the first quarter, seasonally business is low hence for the half year, annualized ROCE averaged to 17% but in the second quarter alone it was 30%.

Priya Rohira Second question relates to more on the sustainable growth rate in the linen segment, based on the consumer behaviour or the likely changes in the lifestyle you have seen. If you could help us on the inside of linen, the volume which should be sustainable one?

S. Visvanathan I think the market for linen is now growing with increasing penetration both firstly, through geographical expansion of linen business into various towns and geographies and secondly, as a overall share of wardrobe for each individual or the customer that are, there is increased use of linen. Therefore we think that this linen growth will be sustainable over the next few years at least.

Priya Rohira Just an observation on CAPEX. We are planning for a little higher CAPEX compared to the H1 in H2. Is this in line with what we would have budgeted this start of the year, for the standalone company?

Sushil Agarwal Compared to budget, some of the capex has been shifted ahead as in general there has been a definitive slowdown in economy. If we see the broad breakup, the large capex is in the agri and Rayon businesses. In the Rayon business, expansion using ENKA Spool Technology is almost on track and we are targeting to commission that plant sometime in the fourth quarter. So that amount would be fully spent this year. While largely the capex should get spent in the second half, there could be some shift of capex in other projects and maintenance capex.

Moderator Thank you. We have the next question from the line of Amit Rathi from Merrill Lynch. Please go ahead.

Amit Rathi My question is on your imported fertilizers. What was the period of sale?

Sushil Agarwal The sale of imported fertilizers starts somewhere in mid August. We had just commenced sale of imported fertilizers last year and scaled up the same in the current year. That's why if you see the trading revenue compared to previous quarter or previous year, growth is noticeable.

Amit Rathi What is the approximate margin on this imported fertilizers and our manufacturing fertilizers?

Sushil Agarwal Typically trading businesses does not have large margin. Broadly around 3-4% would be the range. As we had explained last time, since we already have a strong distribution channel, we are utilizing it to position ourselves as a complete agri-solution provider to the farmers.

Amit Rathi What about this guidance? What is the period of this imported fertilizer, still its September to Jan or throughout the year?

Sushil Agarwal From mid August to mid January the imported fertilizers are generally sold.

Moderator Thank you. We have the next question from the line of Manit Varaiya from Vallum Capital. Please go ahead.

Manit Varaiya My question is related to our NBFC business. What sort of growth plans do we have in mind book size. And what kind of average ROA are we targeting on our NBFC book side?

Sushil Agarwal In last couple of years, if you have seen, we have doubled our book size. But as I said in my opening remarks that we want to grow this book cautiously, to control risks. So we are going to make sure that whichever segment we grow our book, we do take care of respective risk.

Rakesh Singh So we have grown more than ₹ 5,000 Crore in Q2. But it is not the book size only, where we are focused. The focus is on growing it profitably and sustaining for a longer period of time. In terms of your question on ROA, I think we are looking at 2% plus ROA on the book.

Moderator Thank you. We have the next question from the line of Jatinder Agarwal from CIMB. Please go ahead.

Jatinder Agarwal Can I have a breakup of the loan book of ₹ 5,150 Crore?

Rakesh Singh I can give you a break up. Capital market business is ₹ 2,100 Crore, infra business has crossed ₹ 1,100 Crore and SME business also has more than ₹ 1,100 Crore book size. Mortgages which were started as loan against property last year has crossed ₹ 500 Crore. So that is the broad composition of this ₹ 5,150 Crore book.

Jatinder Agarwal This makes it ₹ 4,800 Crore approximately?

Rakesh Singh I just gave you the ballpark figure. There will be something in the treasury,.

Jatinder Agarwal On this capital market, can you give more flavour on individual segments? What are these loans for capital markets?

Rakesh Singh The capital market is quite wide diversified in terms of HNI accounts, broker funding, there is some amount of promoter funding. So it is quite well diversified.

Jatinder Agarwal On the SME business, are these basically all from ABNL relationships or there outside relationships also?

Rakesh Singh It is from both inside as well as outside. We try and leverage the ABG eco system.

Jatinder Agarwal What would be the break up, ABG and non-ABG in terms of this book?

Rakesh Singh ABG would be around 30% of the corporate finance book and remaining would be outside.

Jatinder Agarwal Infra, these are mostly project loans or not or what types actually?

Rakesh Singh We have been very cautious on the infra business, so it is a last mile execution exposure which we have taken wherever the revenue has been tied up. We have power, road etc. projects. So this will be the exposure.

Moderator Thank you. We have the next question from the line of Anubhav Adlakha from Merrill Lynch. Please go ahead.

Anubhav Adlakha My questions are pertaining to the insurance business. In terms of the top-line, we still continue to see de-growth. But would you have any guidance for the year end for FY13. There would be flat or will continue with this kind of de-growth?

Mayank Bathwal The pressure on the top-line continues because of the challenges the industry is facing, that you are aware of. The primary challenge being the lack of full product portfolio. Especially for non-bank backed players like us, we are witnessing transition of our direct sales force to new products that is also impacting. Having said that, in the agency channel led by large players, similar pressures are being faced on growth. Since the productivity in agencies is under pressure, we have been very cautious in managing the scale of our agency channel. So in first half for specific reasons we actually scaled down the agency manager’s size by about 1000 odd people. We will now start ramping up as we get into the busy season. We took a call that it is important to grow profitably rather than just somehow get business. As we are getting into the second half, there has been a few positive developments especially with the intervention of the finance minister. There are a few issues which are being dealt very aggressively by the regulatory office. We still have to wait for the final guidelines to come in, but we are seeing some fairly good work happening on the product approval front and on the distribution side, especially bancassurance, something that we are very keenly awaiting. And in addition, some tax sops that DFM has promised. While some of these might take some time, but at least after a long time, the sector has something positive to talk about. It is difficult to give a specific number of where the growth will end up at the end of year, but my sense is that H2 will turn out to be better than H1 given all these positive developments, especially on the products side.

Anubhav Adlakha Your persistency is one of the best in the industry, do you think it is easily manageable for the portfolio you have and going forward you will be able to manage it?

Mayank Bathwal I think on the traditional side, persistency is going to be lower than the unit link business and that is by nature of that business. Typically it is lower ticket size than we were writing in unit linked. So as we write more and more traditional business, by definition, the blended persistency will start coming down and we are seeing trends. We did expect that traditional persistency will be lower. However, our 13 month persistency though came down by 100 bps from previous year, is still one of the best in the industry at 81%. We continue to put lot of emphasis on persistency and that is what is leading to our good profitable book which is again reflected in the profit that we release every year. Our focus on persistency will remain. There are certain actions we take to make sure that our sales quality is as per minimum standard which, by our assessment, are stricter than what industry generally deploys.

	So that focus will continue and hopefully that will help us maintain persistency better than industry.
Anubhav Adlakha	My last question just to touch upon the profit, would you be able to manage this run rate going to the second half of this year? Or we might see a dip?
Mayank Bathwal	I am not allowed to give any guidance on earnings. It will all depend on a large extent to the sales also, what is the mix of sale in the next six months. We will have to watch that.
Moderator	Thank you. We have the next follow up question from the line of Jatinder Agarwal from CIMB. Please go ahead.
Jatinder Agarwal	Just to come back on the loan book, can you tell me individual loan needs across all these segments?
Sushil Agarwal	For detail break up and numbers, maybe we can take it offline.
Jatinder Agarwal	Can you give the funding mix generally, how is this ₹ 5,100 Crore book is funded?
Rakesh Singh	From the funding side, it is a mix of of commercial paper, long term NCDs and of course the bank lines. So it's a combination of 3-4 instruments.
Jatinder Agarwal	Can we get the broad numbers in some of these segments?
Rakesh Singh	A lot of our book is in the short term lending, so I think about 60% should be funded through the commercial paper, the bank lines should be 25-30% and remaining 10% should be the NCDs. I think that should be the broader composition of our liabilities.
Jatinder Agarwal	There will be some provision for NPAs during the first half, can you share that?
Rakesh Singh	In the first half, NPA and other provisions should be in the range of 15-16 basis points of the loan book.
Jatinder Agarwal	These 15-16 basis points are annualized or it is actual for the period?
Rakesh Singh	I am talking about the actual.
Jatinder Agarwal	Just about ₹ 8 Crore is it?
Rakesh Singh	Yes, roughly in that range, but these are only provisions as per regulations. It has no relation with the recoverability of the loans.

Jatinder Agarwal What could be the gross NPAs in this business?

Sushil Agarwal May be we can take all such questions offline for the benefit of others and keeping focus on strategic questions.

Moderator Thank you. The next question from the line of Rishab Bothra from B&K Securities. Please go ahead.

Rishab Bothra Could you throw some light on how carbon black business is shaping up as the margin has deteriorated further?

Sushil Agarwal As we spoke earlier that it is an industry level issue. There has been fair amount of imports, particularly from China which is affecting the sales volume as well as ability to pass on rise in costs. In the recent development, the industry had approached for safe guard duty and the same has been put in place now. So hopefully with that duty coming in place, we should see some improvement going forward.

Rishab Bothra We have to promoters warrant outstanding, in case the funds are received, how will these be deployed? Whether there will be a debt reduction or some infusion in subsidiaries?

Sushil Agarwal There is capex to be spent in second half of the year. There will be ₹ 800 Crore funding from ABNL on account of investment relating to Pantaloons transaction. These requirements will be met through cash flow from standalone businesses and promoter infusion and partly through reduction in working capital requirement. So broadly I don't foresee major reduction in debt level by March end.

Rishab Bothra We have seen sharp increase in inventory levels and trade receivables if March and September are compared. Is it on account of agri business or from other businesses?

Sushil Agarwal It is mainly on account of increased trading in the Agri business and the major trading sales take place between mid August to mid- January. So the rise in inventory is on account of imported fertilizers stock which gets cleared in ensuing months. Receivables are higher due to slow recovery of subsidy which is industry phenomenon.

Moderator Thank you. The next question from the line of Vivek Sharma from CIMB. Please go ahead.

Vivek Sharma Any guidance for NBAP margins for current financial year?

Mayank Bathwal I cannot give you a guidance but what I can say is that we are holding on to the quality of our book reasonably well. And typically our margins have been slightly ahead of the industry so hopefully with focus on quality of book we should be able to maintain that.

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

Girish Achhipalia On the CAPEX side, we have CAPEX enhancement in the agri business of about ₹ 80 Crore, if you can shed some light what this CAPEX is all about?

Sushil Agarwal This capex relates to customized fertilizer plants project which we have taken up in our Agri-business.

Girish Achhipalia When the revenue and EBITDA from project capex in fertilizer would come through?

Sushil Agarwal Even when we look at our first half results for agri business, there has been some challenges on energy costs side and which is what the project capex in fertilizer business would help to optimize once it gets completed. At this stage, we expect the benefit from these energy savings and customized fertilizers initiatives to complete in next fiscal and benefit will flow thereafter.

Girish Achhipalia Second half of next fiscal?

Sushil Agarwal Most likely in the second half of the next fiscal, some of these things will start reflecting.

Girish Achhipalia You mentioned that debt is going to be flattish. Is it September versus March you were talking about?

Sushil Agarwal Yes that is right. Broadly the question was that what will be the use of the balance promoter infusion which will come during this fiscal. So I was broadly saying on requirement front, there will be CAPEX outflow and there will be outflow of ₹ 800 Crore for Pantaloons transaction – against which cash inflow will be from manufacturing and garments businesses plus promoters infusion. Also some working capital tied up in agri business due to trading business will get released. So directionally we do not see too much of change in the present debt level although directionally it is coming down and some of the ratios are improving.

Girish Achhipalia In terms of insulator business, could you provide us some outlook in the second half and going into next year?

Sushil Agarwal

This business also has been facing challenges of imports particularly from China. We have approached government for levying safe guard duty. Directorate General of Safeguards has recommended levying of safe guard duty and within a month's time frame we are expecting final clarity on this aspect. In any case, the second half is better than first half due to better orders on account of meeting yearly targets.

Moderator

Participants, that was the last question. I would now hand the floor back to Mr. Sushil Agarwal for closing comments.

Sushil Agarwal

I thank everyone for participating in this call.

Moderator

Thank you. Ladies and gentleman, on behalf of Aditya Birla Nuvo, that concludes this conference call. Thank you for joining us, you may now disconnect your lines.