"UPL Limited
Q3 FY 2024 Results Conference Call"
February 02, 2024

MANAGEMENT: **MR. RAJENDRA DARAK – VICE CHAIRMAN – UPL LIMITED**
MR. MIKE FRANK – CHIEF EXECUTIVE OFFICER – GLOBAL CROP PROTECTION BUSINESS – UPL LIMITED
MR. ANAND VORA – CHIEF FINANCIAL OFFICER – UPL LIMITED
MR. RAJ TIWARI – CHIEF SUPPLY CHAIN OFFICER, UPL LIMITED
MR. BHUPEN DUBEY – CHIEF EXECUTIVE OFFICER -- ADVANTA ENTERPRISES – UPL LIMITED
MR. ASHISH DOBHAL – CHIEF EXECUTIVE OFFICER -- UPL SAS – UPL LIMITED
MS. RADHIKA ARORA – HEAD INVESTOR RELATION -- UPL LIMITED

Moderator: Ladies and gentlemen, good day, and welcome to the UPL Limited Q3 FY '24 Results Conference Call. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference, please signal an operator by pressing star and then zero on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Ms. Radhika Arora. Thank you, and over to you, ma'am.

Radhika Arora: Thank you, Darwin. Good day, everyone. Thanks for joining us today for the results for the quarter and 9 months ended 31st December 2023. The presentation, press release and the financial statements have been made available on the website, and we take as having read the Safe Harbor statement. From the management team, we have with us today, Vice Chairman, Rajendra Darak; CEO of Global Crop Protection business, Mike Frank; CFO, Anand Vora; Chief Supply Chain Officer, Raj Tiwari; and Bhupen Dubey and Ashish Dobhal, the CEOs of the Advanta business and UPL SAS. We will start with Mike and Anand presenting the performance for the quarter, followed by the Q&A.

With that, let me now hand it over to Anand. Over to you, Anand.

Anand Vora: Thank you, Radhika. A very warm welcome to all of you. I will begin by discussing the key financial highlights for the third quarter and 9 months ended 31st December, followed by an update on working capital and debt. The global crop protection industry continues to navigate through a challenging phase as headwinds in the form of prolonged destocking and elevated pricing pressure continue to persist.

We had initially anticipated a recovery in H2, but that anticipation was a bit premature as the market headwinds continue to impact the industry. Our quarter three performance was also significantly affected by these challenges in line with the rest of the industry, which is currently going through its worst downturn in decades.

We continued our support to the channel partners by extending higher rebates and accepting sales return, which impacted the revenues for the quarter. As a consequence of these factors, our reported revenue was down 28% for the third quarter and 22% for the first 9 months. Adjusting for one-time transitory impact of higher rebates and returns, the pro forma revenue for Q3 would be INR 10,695 crores, down by 22% versus last year and INR 30,424 crores for 9 months, down by 18%.

In particular, the ongoing destocking exercise had a significant impact in our larger markets of North America, Brazil and Europe. However, our rest of the world region bucked the trend and performed quite well, reporting a double-digit growth in revenues in Q3. The differentiated and sustainable portfolio also continued to outperform as the share of revenue of this portfolio increased to 32% of the crop protection revenues in quarter 3 versus 29% last year, and 36% in the first 9 months versus 29% last year. Mike will cover details of this portfolio in his remarks later.

The impact of rebates, returns and high cost inventory liquidation on contribution profits was more pronounced as contribution margins contracted by 15% in Q3 versus that of the last year quarter 3. If one were to treat these transitory factors as a one-time charge, the pro forma contribution would have been higher by INR 1,532 crores and the contribution margin would have been lower by only 3% versus last year instead of the reported decline of 15%.

Similarly, for the first 9 months, the pro forma contribution would be higher by INR 2,079 crores, and the contribution margin would be largely at par with the last year instead of the reported decline of 5.5%. Further, our organization-wide cost-reduction initiatives are yielding results as we reduced our SG&A expense by 19% year-on-year in quarter 3. We are on track to reduce our SG&A by $100 million in financial year '25 versus the FY '23 base.

EBITDA for the quarter stood at INR 416 crores, down 86% versus that of the prior year. And for the first 9 months, EBITDA was INR 3,583 crores, down by 56%. The decline in EBITDA was driven by the significant drop in contribution profit. Adjusting for the transitory factors impacting the contribution margin, however, the drop in EBITDA for Q3 and 9 months would be significantly lower.

I would like to briefly touch upon the performance of 2 of our platforms, UPL Sustainable Agri Solutions, the India distribution business; and Advanta Enterprises, our seeds business, before moving on to the items below the EBITDA.

Performance of UPL SAS, the India crop protection platform in Q3, was also impacted as revenues contracted by 34% while EBITDA declined by 47%. The key factors attributing to the revenue decline were poor Rabi season in Telangana and Karnataka, and low cotton acreage in North India, which led to high sales return.

Secondly, the low glufosinate demand due to elevated channel stock and increased competition also impacted the results. And finally, our conscious decision to sell closer to the season to optimize working capital, resulted in realignment of some of our sales.

Having said that, on a positive note, we did see very good traction in our newly launched pyroxasulfone solution. We are also expecting glufosinate demand to recover in the coming Kharif season. Furthermore, we are also introducing new products to diversify our crop mix. To give some update on 'Nurture’, our digital platform, it continues to see good traction on the back of launching exclusive online brands for retailers and in-the-farm services for farmers. We have also brought in significant operating efficiency through cost savings.

Moving to Advanta, our global seed platform. It delivered healthy growth for the first 9 months as revenues grew by 11%, driven by higher prices and volumes in sunflower, corn, canola, sorghum and vegetable portfolios. EBITDA grew faster at 16%, driven by improved contribution and controlled overheads.

Coming back to the overall financial results. On the finance cost, there was a marginal decline in the net finance cost from INR 732 crores to INR 716 crores in Q3 due to lower factoring or what we call the securitization on a nonrecourse basis. While for the first 9 months, the net finance costs increased by 16% from INR 1,980 crores to INR 2,288 crores.

The increase in finance costs over the 9 months was mainly driven by a 300 basis point increase in benchmark interest rates. The average cost of borrowing for the quarter stood at approximately 7% per annum. FX loss for the quarter was significantly higher at INR 613 crores. The increase in FX loss is mainly attributable to the devaluation of Argentinian Peso from ARS 366 to $1 to ARS 800 to $1 on 13th of December after the new government came to power in Argentina.

The impact of peso devaluation was INR 297 crores in Q3. It's important to note that out of the impact of INR 297 crores, INR 256 crores came on the day of devaluation that took place in Argentina. Further, we also saw currency devaluation in Turkey and in some of the other countries, besides the hedging there was not possible due to prohibitively expensive cost of hedging. Overall, we reported a net loss of INR 1,217 crores for the quarter due to the transitory one-time impact of INR 1,532 crores on contribution and a one-time FX loss of INR 256 crores that took place due to devaluation in Argentina.

On the working capital front, the working capital days increased by 34 days year-on-year to 155 days. The increase is primarily on account of sharp drop in payables by 16 days and reduced factoring which led to receivable days being higher by 23 days.

Adjusted for lower factoring, receivables days actually improved by 7 days versus prior year. Overall, we expect to end the year with higher working capital days as compared to last year due to lower payables and reduced factoring.

To give you an update on the debt. Our net debt stood at 3.77 billion at the end of quarter 3, reflecting an increase of $439 million versus last year.

Mike Frank: I'll just pick up where Anand left off. However, when adjusted for reduced factoring, our net debt stood largely in line with last year. This is despite the sharp decline in payables, which were down $568 million year-over-year.

Now, looking ahead to Q4, we expect quarter four to be progressively much better. Overall, for the full-year FY24, we expect revenue to be lower by 18-20% and EBITDA to be lower by 45-50% versus FY23. Net loss for FY24 is likely to be around ₹ 1,200 - ₹ 1,400 crores.[1]

To augment the cash flows, the company has taken the following initiatives. We have recently announced a rights issue of up to $USD 500 million. Further, we're also exploring capital raise in our platforms. The proceeds received from the above initiatives will be used to repay debt.

Mike Frank: **And so now we'll move, and I'll provide an overview of the global international crop protection business.** So overall, the fundamentals for the global crop protection market remained strong with farm gate demand at or above last year levels in most markets and prices for commodity grains also remained strong, while coming off their highs of a year ago. Grower margins remained positive, incentivizing them to drive yield and efficiency. This backdrop, however, is different from the short-term realities of the global crop protection market. This past quarter, distributors continued to destock or delay purchases, specifically in Brazil, North America, and Europe.

Note: [1]Following text has been added as the speaker got disconnected on account of a connection issue.

Additionally, there was a margin compression due to sales of higher cost inventory and from higher rebates and customer marketing programs, which were needed to support our channel partners in these markets.

However, you should note that we continue to gain share in most key markets and the level of destocking is expected to decrease going forward. We anticipate the market getting more balanced as distributors start to restock by mid calendar year 2024.

Moving to our results, where third quarter revenue and margins were impacted by price pressure, prolonged channel destocking, higher cost inventory liquidation and higher-than-usual rebates that were needed to support channel partners, as mentioned earlier. Our Q3 revenue dropped by 34% versus last year, and contribution shrunk by 69%, resulting in margin compression of around 1,900 basis points. More specifically, the business faced headwinds due to channel destocking in North America, Brazil and Europe impacting volumes. Brazil and North America also faced margin pressure from rebates.

Outside of Brazil, the rest of Latin America grew 7%, driven by insecticide and fungicide volumes. Even though the average price for key active ingredients have stabilized since Q2, the decline this quarter has been sharp versus last year, aggravated by rebates and this has impacted our top line by 6% in Q3 and 4% year-to-date.

The contribution margin this quarter when adjusting for one-time impact, as stated earlier, is significantly improved and only around 200 basis points lower versus last year. Similarly, with the same adjustments, our 9-month margin is at par versus last year, implying resilience in our business and a strong underlying trend.

I am pleased to share that we have increased differentiated and sustainable volumes in Q3, led by fungicides, and this has supported improvement in differentiated and sustainable solutions mix to 37% versus 28% last year. Further, our NPP solutions in the first 9 months have maintained revenue versus last year despite market challenges.

Through focused efforts and optimization, we have lowered our quarterly overheads by 15%. We continue to drive improvements in our cost base as we move into the next fiscal year.

Let us now go through the regional performance in Q3. In Latin America, our revenue was down by 30% due to price decline. Brazil was the main driver of this decline in the region, impacted by both herbicides and insecticides. However, it had robust growth in fungicides led by Mancozeb products, especially Evolution, Unizeb Gold and Tridium.

I would also like to highlight that our market share in Brazil has increased in 2023 from 8.5% to 9.1%. As mentioned earlier, outside of Brazil, we saw good volume growth in insecticides and fungicides, offset by herbicide pricing challenges with the rest of LatAm posting strong growth.

In North America, post-patent herbicides continue to face channel destocking, while issues related to tactical purchases persisted. In Europe, our revenue declined by 46%, primarily due to destocking challenges and product bans impacting volumes. As in other regions, destocking pressure in the post-patent segment was pronounced in Europe.

The Rest of the World region performed well. Key growth markets were China, driven by insecticide volumes and Turkey led by herbicides. Also, our natural plant protection volumes were very strong in this region, growing by about 20%.

So moving into Q4. We anticipate channel inventory to normalize in Latin America, excluding Brazil, elevated inventory levels in North America, Europe and Brazil are expected to subside in the next few quarters. We expect Q4 to be weaker versus last year. However, the good news is that pricing of key post-patent active ingredients have now bottomed out since Q2. With unusual impact from Q3, mostly behind us, we expect sequential margin improvement in the fourth quarter.

We remain focused, making improvements in our operating model and business quality. Our focus remains in improving the mix of differentiated and sustainable products, operational efficiencies to drive cost reduction and working capital management. Additionally, we are building the organization for the future, creating a robust pipeline of new products and leveraging our position in key emerging markets.

And our manufacturing teams have made great progress in their drive to improve our manufacturing cost. Overall, while the current scenario was challenging, we have invested significantly in customer relationships and building a more capable and efficient organization, all expected to benefit us in the medium to long term.

With that, we'll now open it up to questions and answers.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Saurabh Jain from HSBC. Please go ahead.

Saurabh Jain It has been pretty much a formidable quarter for us. How do you expect fourth quarter to be because it's more of a US and Europe-heavy quarter. And we are facing issues on the key product glufosinate. Is it fair to assume that the quarter that has gone by is the worst quarter for UPL and things should start to improve from here on? And whether there would be any profitability to expect on net profits in the fourth quarter? That is my first question.

Mike Frank: Saurabh, it's Mike here. Maybe I'll take the question first. I'm not sure if Anand and the team have been able to rejoin. So firstly, Saurabh, yes, we do believe that Q3 will be the most challenging quarter, which is just behind us now. In Q4, we're still going to be challenged by pricing as we have in previous quarters, as we discussed in the prepared remarks.

Much of the rebate issues are behind us, especially in North America. There still may be some issues that we're working through in Brazil. And overall, we would expect to have a net positive EBITDA and greater margins going into Q4.

Saurabh Jain: Okay. So that paints a very concerning picture. And at the same time, what my understanding is that in 9 months the overall EBITDA that we have done is something about INR 3,600 crores, right? So expecting some additional EBITDA even on this number would kind of make the FY '24 EBITDA very small. So, trying to understand what are your guidance end of FY24?

Mike Frank: Okay. Look, since this is a question on the overall balance sheet and at the UPL Limited level, I think we should just park this until we get on and back on the line. Maybe operator, if you can dial the number in his office, so that he can get back on the line.

Saurabh Jain: Okay. In that case, if I may ask, while it might be early to kind of seek for any guidance on how FY '25 would look, but broadly speaking, do you expect a material improvement in terms of your overall profitability for next year? Because even if you do some sort of recovery in terms of overall revenue growth, does it look materially a better FY '25 from here on?

Mike Frank: Yes. So in the international crop protection business, again, the underlying strength of farm gate demand is strong. We would expect going into 2025, our fiscal year '25 that the grower demand and the distribution demand is going to start to equalize. Obviously, we experienced significant destocking this year. And so as the destocking levels out and we get more of an equilibrium between grower demand and distribution demand, that will, of course, be a tailwind on a comparative basis.

Also, from an inventory cost standpoint, we will be going into our next year with a much better cost position on our inventory as we replenish inventories. We now have a lower cost basis, and so that will also be a tailwind for us. So, look, we would expect the price challenges to continue at least in the early part of next year.

And so that will be similar to this year, but some of the underlying impacts that we dealt with this year should be behind us. We would also expect returns and rebates to balance back to more normal levels versus the heightened levels that we experienced this year.

Saurabh Jain: Okay. Understood.

Saurabh Jain: So probably what kind of net debt expectations would you be having now end of FY '24? And given that we have only done an EBITDA of about INR 3,600 crores in first 9 months, add some incremental EBITDA will be doing in Q4, it still seems may end up kind of pretty lower than what were the initial expectations. So what kind of concerns can emerge out of this keeping in the context of the rating issues that we have faced in the past?

Anand Vora: Saurabh, I mean, clearly, it's a challenging time here. As you know, the rating agencies look at both not only does the net debt, but they also would look at the net debt to EBITDA. We have been hit on both accounts, a, the debt is a bit elevated. At the same time, EBITDA is down. So, we are engaging with them.

Clearly, it's an industry phenomenon. Every player in the industry is going through this pain as you would see when other agchem companies announce their results.

So, we are keeping up our engagement with the rating agencies. Finally, it would be up to their decision whether if they can give us some more time considering the overall downturn in the industry, but we'll have to wait and watch once we share the numbers as to how they would look at it. But clearly, if one has just look at the numbers of our net debt as well as EBITDA, it's going to be challenging to retain our investment grade.

Saurabh Jain: And any indications on your end of year at guidance?

Anand Vora: As of December, we are at about $3.7 billion. We are putting all efforts to see if we can bring it to around $2.5 billion, and this is without the rights issue. I think we are looking at, as I said, up to 500 million is what we have got the Board approval for.

We should announce that shortly before the end of this month. And hoping to get the money in. So, if everything goes as per the schedule, then that should further help us to bring it down from $2.5 billion to maybe another $400 million to $500 million, whatever that number is, there would be some reduction there.

Saurabh Jain: Somewhere closer to $2 billion, what you have been guiding earlier.

Anand Vora: I mean, yes, $2.5 billion is what we are working towards at this stage and then the rights whatever that amount comes to.

Saurabh Jain: Yes. So, post rights, it could be somewhere closer to $2 -2.2 billion. Is that a fair assessment?

Anand Vora: Yes.

Moderator: The next question is from the line of Madhav from Fidelity.

Madhav: My question was a bit more like on the longer term. If I look at UPL's EBITDA margins over the last decade or a bit longer, we've been at that 20% EBITDA margin mark. This is like a year where margins have come down. My understanding is that we are a global scale company with well-integrated capacities.

So, my couple of questions were basically, are we at a cost disadvantage to China in the molecules which we make? And if that is not the case, if you are at par with them, then whatever pricing pressure we're seeing today would mean that even they are bleeding quite a lot. So prices should come back.

So, just wanted to understand in terms of the cost curve where we are versus them. And I don't think we were over-earning in the past decade because margins were very stable. So, just your outlook on whenever this thing normalizes, how margins could look like 2, 3 years out for UPL? Or has something structurally changed in the industry that our margins should be lower versus what it was over the last 10 years?

Rajendra Darak: This is Rajendra here, I think, sorry Mike, you want to answer.

Mike Frank: Go ahead, Rajendra. Go ahead.

Rajendra Darak: Okay. Just to answer your first question on cost curve of UPL from competitiveness. Just to give you a data point on our top 15 molecules, if we take the cost of UPL as of the latest cost of production, the latest China price, on an average UPL is 15% plus competitive versus China today. So, if you're looking at China at the bottom, even then UPL is still 15% competitive versus China.

On a molecule-to-molecule basis, we are anywhere from 30% to 40% more competitive; in some cases, obviously, we are at par in China, except for only 1 molecule, where we are above the China cost today. And here also we surely have a line of sight as to how we can go below China. So, this is just to give you the reference data point. Mike, go ahead.

Mike Frank: Yes. And so with that as the backdrop. And again, as we talked about this year's results for the first 9 months, if you were to adjust for both high-cost inventory and the excessive rebates that we invested in this year, contribution margins would be very similar to that of last year.

Additionally, of course, we've also lowered our overall cost basis and expect next year to have a lower cost basis than we have this year. And so look, I think, prices will continue to be challenged going into next year. You've asked about kind of looking out 2 or 3 years. We will have an Investor Day in May, where we'll give more clear guidance in terms of how we see the mid- to long- term unfolding.

But again, we would expect our contribution margins to be back in line going into the near future. We'll have a lower cost SG&A base. And then the EBITDA margins should have an opportunity to eventually get back to the levels that we've seen here in the past.

Madhav: Got it. And my second question was the savings which we've had on the SG&A side, about $100 million what we are targeting this year. As the business hopefully recovers, might take a year or a little bit longer, we don't -- we do not know at this point, could be a bit faster as well. But these savings, are they like sustainable in nature? Or do some of these costs come back, hopefully, once the business normalizes?

Mike Frank: Yes. So, the commitment that we've made is to have a $100 million cost savings comparing FY '23 to FY '25. We're on track to deliver that, and we're delivering it in a sustainable way. And so obviously, there's some level of discretionary spending that we reduced, but we've also taken out structural cost. And so we feel confident that we can deliver the SG&A savings in a sustainable fashion.

Madhav: Yes. So my point was exactly that, like how much of the saving is more structural versus discretionary. So once the business say bounces back at some point, some of the costs, which come back versus what has been just taken out of the system?

Mike Frank: Yes, the majority of the takeout is structural takeout.

Moderator: The next question is from the line of Vishnu Kumar A.S. from Avendus Spark. Please go ahead.

Vishnu Kumar A.S.: Challenging times, but apart from inventory problem, we've also seen that the Chinese are dumping product at record level. How does this impact the timelines of the recovery? And how confident are we that even by Q2 '25, there will be the recovery, given that the goal post has already moved, and China continues to dump excess product in the market. If you could talk also about this? And also regionally, how do we see the current problem behaving? And just some sense on how confident are we on the recovery?

Mike Frank: Yes. So, as per Rajendra's comments in terms of our competitiveness versus China, even at these low prices that we're seeing out of China, we're very competitive. With the exception of 1 active ingredient, which we have a glide path on to improve. So, look, as we are replenishing our inventory with lower cost inventory coming out of our plants in India, we're going to be very competitive in the marketplace.

And again, we would expect our contribution margins to get back into the range that we've seen in previous years, excluding this year. I think the recovery will take a little bit longer in Brazil and North America than other regions. And as we talked about in the comments earlier, our business is performing very well across other parts of Latin America, across Africa, Asia. And so we would expect that momentum to continue. I don't know, Anand or Ashish, if you want to add any further color?

Ashish Dobhal: Yes. This is Ashish here. What Mike said is right. The new inventories we are getting is at low cost, and we are also seeing overall destocking in the market. And I think definitely in the next 2 quarters, we should be back.

Rajendra Darak: And Mike, maybe you can say how China price have evolved in the last 2 quarters, how you have seen it being stable or whatever it has been. So maybe that's also gives an idea.

Mike Frank: No, that's good. Yes. So, look, over the last 2 quarters, we've really seen the prices out of China stabilize. Herbicides are maybe down about 1%. Insecticides and fungicides are really flat over those 2 quarters. And so, we really do believe that we're seeing the bottom at least based on the current feedstock costs.

We can see the profitability from a number of the public companies that are crop protection manufacturers in China. And we can see that in essence, they're selling at or near their variable cost. And so, there's not a lot of space at this point in the post-patent segment for the market to decline any further. Obviously, it's hard for us to predict if and when it will improve. But at this level of profitability, you would say it's not sustainable over the long term based on the current situation in China.

Moderator: We have the next question from the line of Siddharth Gadekar. Please go ahead.

Siddharth Gadekar: First, just wanted to understand what has gone wrong in this year in our India business, given that if you look at our peers, they have done relatively better, and we are down 22% volumes. And in terms of next year, how should we look at the India business?

Ashish Dobhal: Ashish here. I think India business, we essentially had 3 big reasons why we were left behind a little bit is that cotton and pulses are our key crops, and we all know that I think these are the crops which are hit the most this year. We are a dominant player in that. The second piece, of course, is glufosinate demand this year or rather the overall nonselective herbicide demand was down in Kharif first and then even in rabi now, where Karnataka and Tamil Nadu are our big markets.

We did have some elevated channel stock for this, and we did have some initial competition, but the brand still is a strong brand in the market. And so I think it's a large product for us. So this impacted us disproportionately. And three, of course, especially for this quarter, we also are taking conscious call to sell closer to the season because with a little bit of a price ambiguity, the overall business model is shifting a little bit towards closer to the season.

We had 2 bad years back-to-back for cotton and pulses. So I think we definitely feel that we should come back big time on these 2 crops. We also definitely feel that our brand equity on glufosinate is good. And with the destocking for this product largely behind, I think even if we get moderate to decent rains, I think this is a product that should fly.

We are also having a lot of new launches in some of our so-called not-so-strong crops, whether it is corn or whether it is sugarcane and paddy, which should help us to come back properly in the next 2 to 3 quarters.

Siddharth Gadekar: And in terms of our inventory in the Indian channel, are you now below the normal level? Would that be a fair understanding given how our performance was this year?

Ashish Dobhal: Yes. We are as far as the India business is concerned; we are slowly coming to normal levels now.

Siddharth Gadekar: Okay. Sir, secondly, now in the international markets like in Brazil and North America especially, is there any sense of how much high-cost inventory are we still carrying? And what kind of hit can we see in the fourth quarter? Or we are entirely done with the high-cost event?

Mike Frank: Yes. So, Mike here. Look, we have a path we believe to clear out the high-cost inventory as we exit this year. So, there will still be some impact of that as we go through Q4. I think, a little bit less than we experienced in Q3. And again, as I mentioned earlier, from a rebate standpoint, those are essentially cleaned up in North America, and we've got a few that we're still working through in Q4 in Brazil.

Siddharth Gadekar: So, going into FY '25, we will be entirely sitting on the low-cost inventory? Would that be a fair understanding?

Mike Frank: Yes, we'll be very close to that position. So, I would expect very little impact, if any, from high-cost inventory as we enter FY '25.

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

Abhijit Akella: Mike, I was just hoping to get your perspective on this inventory situation in the global marketplace. The destocking has been dragging on now for the past 3 or 4 quarters, and it still seems to be taking another couple of quarters. So, any sense of just exactly how much is still left there, maybe in terms of the size of the industry? Any metrics or data that you might be able to share would be really helpful.

Mike Frank: Yes. So, I mean, as you know, in most of our markets, there's only 1 season per year, and unfortunately, once that season passes, then it takes another 3 quarters before you get to restock for the next season. So that's one piece to keep in mind. The second piece is, I would say the inventory levels in the channel right now are lumpy.

And so, it's really active ingredient specific. If you just think about the various categories, it's probably the non-selective herbicide category in Brazil, in North America, that is still being normalized to any inventories where the channel will be targeting.

And so, I think we're kind of down to that point where there's a few markets with a few AIs that are still getting back into balance that are important to us. For most of our AIs, we're getting back into a pretty good balance where inventory levels would be normal to where we would expect them to be.

Abhijit Akella: Understood. And just on the China issue. Have you sort of started to see production being shut down by some of the producers in China given the situation? And are we seeing improvement in terms of the supply outflow coming out of China in recent months?

Mike Frank: Yes. Look, if you just look at the North America as an example, the China imports into North America last year from January to November were down over 50%. Same in Brazil, in the same period, they were also down around 50%.

Now we haven't seen capacity come offline yet. Obviously, most of the manufacturers are running at a low level of their overall capacity in many of their plants. But at this point in time, we haven't seen plants permanently shut or specific consolidation happen in the industry. We would expect that to happen if the situation doesn't change, but so far, we haven't seen those shutdowns or the consolidation.

Moderator: The next question is from the line of Steve Byrne from Bank of America. There is no response from the current participant, we will proceed with the next question, which will be from the line of S. Ramesh from Nirmal Bang Equities.

S. Ramesh: Yes. So, the first part is in terms of the operating cash flow, you adjust the inventory losses. So -- and the Argentinian forex loss. So, you're talking about something around INR 2,250 crores. Is that kind of cash flow visible in this quarter?

And do you see any improvement in your net working capital in terms of number of days, although you said it will be higher than last year. Compared to 3Q, will your working capital come down and thereby, you'll be able to release some cash. How do you see that in the collection in the fourth quarter?

Anand Vora: As you know, the fourth quarter is when we usually get a fair amount of collection. And at this stage, we are seeing that collection coming. So, we expect it to be similar to that of the previous year same quarter.

S. Ramesh: So, in terms of operating cash flows, net of working capital, you will be able to manage the operations and so forth without any incremental debt. Is that a fair understanding?

Anand Vora: There could be a marginal increase, but not significant. The net debt will come down. We have $3.7 billion as of Dec’23. We are talking about getting it down to $2.5 billion roughly from the operating side in Q4. So that's something that we are working towards. And we expect that to come.

S. Ramesh: Okay. So, in terms of relative market share since you said, Argentina was badly hit and there's been very mixed news flow in Argentina about the politics and the drought. So, what is the share of Argentina in your overall portfolio? And how is that doing in this quarter given that there's is a big currency devaluation? And -- is that all done and dusted? Or is there still some overhang from Argentina?

Anand Vora: Mike, on the business side, maybe you can update, and then I'll say on the financial side, I can talk about.

Mike Frank: Sure. Yes. So, Argentina has been a good market for us this year. If you go back a year ago, they had a significant drought and productivity was low and use of crop protection products was low. Coming into this year, they experienced normal rains. And so, the planted area went back up and farmers invested in crop protection products. And so, our business is up nicely in Argentina this year. So good performance in the market.

S. Ramesh: So, any number you can share in terms of what is the share either in LatAm or in the overall portfolio from Argentina?

Mike Frank: Yes. We don't break out the country-specific numbers. But I would say Brazil is by far the largest market in LatAm, followed by Mexico and then Argentina would be third.

S. Ramesh: Okay. And in the fourth quarter or first quarter, you mentioned your capacity utilization has been reduced. So, in terms of your manufacturing, are you still running at lower capacity, what's the current capacity utilization? And when do you see that move up back to normal capacity utilization?

Mike Frank: So, Raj Tiwari, why don't you take that question. They might have got disconnected. Look, I mean, overall, our volumes year-to-date are down mid-single digit. We do expect good volume in Q4, but probably down very low single digit versus last year. And so our plants are running a little bit slower than they ran last year.

Of course, we're in the process of building our plants for FY '25 based on not expecting the same amount of destocking that will be conducive for volume growth. And as we continue to expect market share gains in the markets where we're performing very well and that will also be conducive for more volumes. And so, I would say our expectation while we're going to continue to manage working capital very closely, is we'll be running the plants in FY '25 at a level of slightly above where we ran them in this year.

S. Ramesh: If I can squeeze in a last question. The cost of inventory coming down, is it possible to give a sense in terms of what is the percentage decline in the value of the inventory just to get a sense?

Raj Tiwari: Yes. So year-to-date, if you see, inventory is about INR 17,000 crores vis-a-vis about INR 20,000 crores last year. So, INR 3,000 crores of inventory, which is down, largely on account of two factors, very small contribution on account of volume, but largely on account of cost.

I mean this is where you see that the channel inventory will be now at a rebased cost, which is much lower cost. And therefore, what Mike alluded is that we should be able to get back to normalized gross margins in FY25.

Moderator: The next question is from the line of Steve Byrne from Bank of America. Please go ahead.

Steve Byrne: Mike, you made a comment about it's going to take a little bit longer to recover in the US and Brazil. I was curious whether you're referring to destocking? Or were you referring to price? I was also curious to hear your progress on your launch of your brand of the Chlorantraniliprole product?

Mike Frank: Yes. Yes. Thank you, Steve. So, look, we're not expecting a recovery on price into the near term. Obviously, if that were to happen, that would be positive. But we're expecting that we're going to continue to have low prices coming out of China, as we talked about, we can compete against that and earn back our historical margins.

I think from a destocking standpoint, again, in North America, I would say it's largely glufosinate that we're still expecting to see some destocking going into the next couple of quarters. In Brazil, as you may know, Steve, the drought that they experienced through the Cerrado region did impact the farm demand.

If you take, for example, the sucking pest segment, which we're very strong in. Typically, growers spray about 3.2x per year on a soybean crop for sucking pests. This year, they sprayed on average about 2.2x. And so that's not really about destocking. There was some demand destruction just because of the drought in Brazil.

Now obviously, they've got a safrinha corn season coming up. And so we'll use some of the product to manage insects in that crop. But again, I think we're down to glufosinate in North America. And then it's just based on grower demand for the most part in Brazil. Coming to your question on CTPR. We have launched CTPR in a number of geographies. It's very early days. What we've launched so far has been solo mixtures.

Our strategy for the most part is to focus on value adding combinations. And so that's really where we're moving to. We're just in the process of starting to market a combination product with CTPR in India, and we're looking forward to those opportunities in other markets here in the next 18 to 24 months.

Steve Byrne: And Mike, if ‘I could squeeze one more in with you. What is it that makes it so challenging to monitor the channel inventory levels? Or do you think that you've made some adjustments in your own assessments to be able to monitor that better?

Mike Frank: Yes. So, look, we've got a good handle on the level of inventory of our products in the channel, where we have less visibility is other products. And so, I think if we go back over the last couple of years, there was overstocking because of the challenges in supply chain or the risks that were inherent in the supply chain at that time. And so again, we knew exactly what was happening with our inventory, but we didn't have clear visibility on our competitors' inventories.

And so, when it all shook out and prices came down and distributors wanted to really destock because supply chains are viewed as highly reliable today, this is the impact that we're seeing. Obviously, in markets like North America and Europe and Brazil where there's been more consolidation in distribution channels, there's also more capacity to hold inventories.

And so if you look at other parts of the world where our performance is really good this year, like in Latin America, excluding Brazil, and in what we call the rest of the world markets, those are more fragmented markets where inventory holding capacity is lower and you just naturally get less of an impact either when you're overstocking or destocking.

Moderator: Ladies and gentlemen, we will now take the last question from the line of Tejas Sheth from Nippon Life India AMC. Please go ahead.

Tejas Sheth: In the markets of North America and LatAm, how are the distributors faring. So, are they also kind of losing money in this whole trade or it is something that we are taking the larger brunt of this whole destocking and hence, distributors are still faring well?

Mike Frank: Yes, it's a good question. And look, I would say it's a bit of a mixed bag. There's a few distributors in Brazil that are publicly traded. So, you can see their results. Likewise, there's some large co-ops in North America and a large public company that is also a distributor in North America. So, you can see those companies and their financial reports, I would say they've also had margins compressed significantly in the last 12 months.

And so, I would say the burden is being somewhat shared across the supply chain, probably a little bit more of the upside during '21, '22 was enjoyed at the supplier level. And this year, some of the downside and the squeeze in margin is also being felt harder with suppliers. But there is some sharing of the pain, I would say, across the supply chain.

Tejas Sheth: And also, if you can give some color on how the innovators are behaving because they obviously have a kind of a larger end of the product, I mean much more value-added products. Are they also getting very, very price competitive on your portfolio? Or they are kind of not as competitive versus the generic? Is the generic prices and the innovative prices widened in the last 12 months or they have narrowed?

Mike Frank: Yes, they have definitely widened. And again, we can see it in our own portfolio and the performance of our differentiated and sustainable products, our margins have roughly held in line with historic levels, north of 40%. But the margins in our post- patent segment is what's got impacted the most. And so I would say that trend is playing out across the industry where differentiated products, prices have largely held with where they were over the last few years. But the post-patent segment is where the significant prices come down.

Now of course, there is substitutability in the marketplace as well. And so there is some pressure. And as commodity prices for grains have come down, growers are looking at all their options. And so, I think this is going to continue to play out over the next selling season, where there probably will be some upside in volumes and market share towards the post-patent products, but margins will continue to be challenged there. And likewise, we're seeing the prices come down very slowly if at all in the differentiated segment.

Tejas Sheth: Just last question to Anand. Why are we paying to the suppliers at a much lower days? I mean why we are not maintaining payable days at a higher level and hence, kind of at least get some mitigation of higher inventory days and receivable days? In a very high cost of borrowing environment, why are we paying much earlier to these suppliers?

Anand Vora: Tejas, it's just that the level of activity has come down due to drop in the volume as Raj alluded. And it's largely because of the drop in level of activity. And of course, we also have the prices coming down. So as a result, you are seeing a lower level of payable days.

Tejas Sheth: Okay. And what are we doing on the capital expenditure side, are we deferring our cash outflows there? Are we postponing the larger projects which we were planning to add or we are continuing with it? Typically, we spend INR 3,000 crores to INR 3,500 crores on the capex.

Anand Vora: We have slowed down on capex. For the first nine months, capex spend was $190 million, and for the full year we will likely close at $250 million.

Moderator: I would now like to hand the conference over to Mr. Anand Vora for closing comments. Over to you, sir.

Anand Vora: Thank you, everyone, for joining us on today's call. If there's any follow-up questions, feel free to reach out to Radhika Arora or myself, and we should be happy to answer your calls. Thank you once again.

Moderator: Thank you. On behalf of UPL Limited, that concludes this conference. Thank you all for joining us. You may now disconnect your lines.