Aarti Industries Limited

Q1 FY22 Earnings Conference Call Transcript
August 9, 2021

Moderator: Ladies and gentlemen good day and welcome to the Aarti Industries Limited Q1 FY22 Earnings Conference Call. As a reminder all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I would now like to hand the conference over to Ms. Shruti Joshi from CDR India. Thank you and over to you, ma'am.

Shruti Joshi: Thank you, Janice. Good afternoon, everyone. Thank you for joining us on Aarti Industries Q1 FY22 Earnings Conference Call. We have with us today on this call Mr. Rajendra Gogri – Chairman and Managing Director, Mr. Rashesh Gogri –Vice Chairman and Managing Director and Mr. Chetan Gandhi – CFO of Aarti Industries.

Before we begin the call, I would like to point out that some of the statements made in today's call may be forward looking in nature and a disclaimer to this affect has been included in the results presentation shared with you.

I would now like to invite Mr. Rajendra Gogri to talk about the performance of the company and his outlook on the business. We will then open the forum for Q&A. Over to you, Sir.

Rajendra Gogri: Thank you, good evening and a very warm welcome to all of you attending this call. I hope all of you and your families are in good health. We hope to see the government's vaccination drive bring about mass immunity and the country coming out stronger after a very tough phase.

I trust that all of you would have received the Q1 FY22 results presentation that has been uploaded on the stock exchanges website earlier today.

First a review of our financial performance:

As you may have seen, we have started the year on a strong note – our revenues crossed Rs. 1,500 crore during the first quarter, which was up by 45% on a year-on-year basis. While this is a significant jump, we are currently monitoring our performance more on a quarterly basis as the first quarter of the previous financial year had a significant impact of the pandemic on production and operations. In this context, we are happy to report about 12% revenue expansion over the preceding quarter – that is compared to Q4 FY21. During the quarter, there was a sharp increase in raw material prices, fuel prices and logistics costs, which also contributed to the increase in topline for the quarter.

Q1 EBITDA of Rs. 314 crore is also higher by 20% compared to Q4 led by increased utilization of capacities and value addition in the product mix. During the quarter we had witnessed Rupee depreciate by about 1.20 vs US dollars. This resulted in a mark to market loss for the ECB, which has been the cause for the rise in the finance costs by over Rs 13 crs for the quarter. Our profit after tax came in at Rs. 165 crore, up 21% over Q4, doubling the level achieved in Q1 FY21.

Both the topline and EBIDTA in the reported quarter are our highest ever in history. Thus, we have successfully extended the growth momentum achieved in the second half of FY21.

Continued volume expansion in the speciality chemicals business has reflected in topline and EBIDTA growth for the segment. Pass on of the higher input costs and logistics costs also contributed to the surge in topline for the segment. These factors resulted in the topline growth of about 50% on YOY basis and about 12% on QOQ basis for the segment. We have seen return of demand from established markets to almost pre-covid levels and in some cases, it has surpassed the precovid demand volumes – that are clearly driving improved EBIT. Segment EBIT of Rs 237 crs for Q1FY22 portrays a growth of about 13% on QOQ and about 85% on YOY basis. As you are aware, we have a pricing model wherein the variations on RM are passed on to the customer, thus the better way to look at our performance is the change in absolute EBIT. Income in this business segment includes recognition of about USD 4.5 million in Q1 from the shortfall fees in respect of the first long-term contract.

Now for the Q1 production update. Production for Nitrochlorobenzene was at 18155 metric tons compared to 13070 MT a year back. Similarly, for hydrogenated products we have achieved production of 2920 MT compared to 2050 MT last year. On the Nitro Toluene front, the production for Q4 was 3440 MT, compared to 2140 MT in the same quarter last year. We operated at over 80%-85% capacity utilization across our established locations and expect to deliver steady performance improvements going forward as new facilities scale up volumes.

Our pharma business grew by 17% YoY to Rs. 240 crore during Q1 and by 7% over Q4. The business continues to maintain growth momentum based on higher utilization of facilities that are driving volumes. EBIT for the pharma segment for Q1FY22 was Rs 48 crs which was fairly similar to the EBIT for Q4FY21. In Q1, there was some impact on margins due to higher inventory of the final product, which could not be shipped due to logistics issues. Further business visibility in Pharma is based on higher volume from regulated markets, value-added products and new introductions of intermediate products. As you would know, we are currently implementing additional capacities for API's and intermediates that are expected to be operational in the second half of FY22. We expect volume expansion to be supported by robust margins in this segment based on a pipeline of approvals that strengthen our position in therapies such as anti-hypertensive, cardiovascular, oncology and corticosteroids.

Now, an update on capital expenditure. We have incurred capex of Rs. 295 crore in the first quarter, against the annual planned capex of about Rs 1500 crs. At present, we also have several other capital investment projects in the pipeline. These includes Expansion of USFDA capacities at the API unit located at Tarapur and at the intermediates unit at Vapi, Set up of production units for the 2nd Long Term Contract at Dahej SEZ, for the 3rd Long Term Contract at Jhagadia and the NCB capacity expansion at Vapi, Expansion cum asset upgradation for our Acid Unit at Vapi, amongst various other projects which are underway. As guided last time, we are also undertaking growth projects driven by R&D and innovation. These include:

- New Value Chains to be introduced (for instance the Chloro Toluene value chain)
- Existing value chains expansion by addition of new products and chemistries.
- Additional Contract Manufacturing opportunities being explored
- Manufacturing outsourcing and strategic alliance opportunities
- Setting up of UMPPs
- Expansion of existing pharma products and introduction of new pharma APIs and intermediates

With the addition of new chemistries and value added products, our objective is to launch 40+ products for Chemicals and 50+ products for Pharma, driving growth beyond FY25. These initiatives provide the blueprint of growth over the near term horizon till FY24 as well as for the longer term horizon till FY27. These projects entail an investment of about 4500 to 5000 crs over next three years. To augment various needs, the company had raised growth capital by way of QIP of Rs 1200 crs in the month of June 2021. The issue was oversubscribed with good quality institutional investors laying their confidence on our growth plans. The issue was closed with the participation of long term investors accounting for over 70% of the issue, of which FIIs had a larger share.

Thus to summarise, we have a golden era of opportunities for the growth of Indian Chemical and Pharmaceutical industry and also to enhance its share in the global markets. We remain committed to work on these opportunities and drive on the growth journey which we have guided you during the last concall. In FY22, we remain enthused about the prospects of the business supported by increasing utilization of recently commercialized facilities – that is additional chlorination capacity at Jhagadia and the Phase 2 unit at Dahej SEZ and other projects to be commissioned this year. Based on this visibility, we re-iterate our topline and bottomline growth guidance of 25-35% for FY22.

With that, I conclude my opening comments and we will open the floor for the Q&A session. Thank you..

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-and-answer session. The first question is from the line of Naushad Chaudhary from Systematix Shares.

Naushad Chaudhary: On the second long-term contract – I believe it was expected in Q1 FY21 but has seen almost a year's delay. Are the delays from the Company's side? Would there be any costs overrun in terms of the overall CAPEX that was required for this project; I think earlier it was Rs. 300 crore, would there be any addition because of the recent commodity inflation?

Rajendra Gogri: The project was mainly impacted by the first wave of COVID last year and then the second wave this year, this is the main reason; obviously, the demand was also impacted globally. We are now targeting to commission this plant in the second half of this year and there is no significant cost escalation for this project.

Naushad Chaudhary: On the chlorination plant – the capacity addition of 65,000, I believe was primarily for the requirement of the first long-term contract project which got cancelled. Since it has already experienced two quarters, what is the status now and how is it expected to be ramped up?

Rajendra Gogri: As you rightly mentioned the cancellation of the first contract has impacted the production for these products. However, we see the volumes growing progressively, in this plant in the second half of this year and in the next year as well. It was also mentioned earlier, that we will be making the same product and expect to start seeing major sales from FY23.

Naushad Chaudhary: Is the strategy to use it captively, with the remaining being sold in open market?

Rajendra Gogri: Yes.

Naushad Chaudhary: In terms of the overall gross block, in the last two years the Company has added ~Rs.1,800 crore; plus, as of March '21, it had ~Rs.1,200 crore of working capital. Thus, the total investments made in the last two years is ~Rs. 3,100 crore. What would be the breakup of this Rs. 3,100 crore that has been invested. Also, I was not able to find out about the Rs. 600-700 crore of CAPEX.

Chetan Gandhi: So, you are looking at the previous two years' CAPEX number?

Naushad Chaudhary: Yes. I think chlorination, NCB, PDA, some Rs. 75 crore in R&D and then there was an investment of Rs. 150 crore on Jhagadia land and then in all your three years there will be normal capex aswell.

Chetan Gandhi: Pharma CAPEX will be ~Rs. 150 odd crore where we are adding the capacity for both the US FDA plant as well. So that is also there.

Naushad Chaudhary: So, let's calculate it this way – Rs.1,000 crore has been invested in chlorination, Rs. 150 crore in NCB, there were some Rs. 70-80 crore in PDA and Rs. 75 crore in R&D.

Chetan Gandhi: You are mixing a lot of numbers; can we take it up separately?

Naushad Chaudhary: Yes, we will take it offline.

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

Rohan Gupta: Could you please give a breakup for the volume and the price led growth in the current quarter on YoY basis, sir?

Rajendra Gogri: Structurally the volume growth on QoQ basis is about 9-10%.

Rohan Gupta: This is on QoQ basis.

Rajendra Gogri: Yes.

Rohan Gupta: Benzene had seen a sharp increase in prices, almost by 50-70%. The Company had a significant amount of increase on a QoQ basis as well. Is that not reflecting in the sense of revenue growth in terms of pricing?

Rajendra Gogri: Revenue growth is higher, revenue growth in speciality chemicals is almost 20% QoQ.

Rohan Gupta: Yes, that only leads to 10% price increase, price led growth.

Rajendra Gogri: That has been by the volume growth.

Rohan Gupta: The raw material price increase has been much sharper and faster in the current quarter. The prices of benzene continue to vary. Do you see that the price led growth was muted in the current quarter and would also be happening in subsequent quarter?

Rajendra Gogri: Basically, there is a lot of value addition also and benzene is one of the raw materials; so there are other raw materials and a lot of value addition comes in.

Rohan Gupta: On the long-term contract – the Company has already received the QIP money and have a strong balance sheet. You had been looking for a long-term contract since the last 3-4 years i.e., since the first amount raised but so far you have only been able to see two large contracts and one small contract, unfortunately one of them has been cancelled. Is the Company looking for more of such long-term contracts and would you be in negotiations with customers to close any deal which could be expected over the next one year? The Company already has a strong balance sheet to for this kind of a contract. How is the business scenario ramping up?

Rajendra Gogri: We have given the details of these three contracts on the public domain based on SEBI regulations. We have few 3-5 years contract which gets rolled over at the renewal. For instance with a customer we have a three-year contract rolled over five times, in the past. Only the one which are for large value or for tenure above 5 yrs executed over last 2-3 years are in the public domain. We continue to work with customer for engaging for more long term arrangements; some of them may come in public domain.

Rohan Gupta: Would you be saying that there is a change in the communication strategy from the Company, as earlier, you had mentioned that these long-term contracts are in public domain. Now, probably the Company wants to continue with the focus on growth and discussing quarterly numbers rather than publicising any such long-term contract that they win?

Rajendra Gogri: It is the smaller tenure and value that we have not been putting in public domain. When the significant contracts with larger tenure and value come in, those will be in public domain. We will have a mix of both; it is a continuous trend.

Rohan Gupta: My question was related to that, it being almost 3 years ago that the Company got these kind of long-term contracts and since then, the industry's scenario has improved a lot, but we have not heard anything in terms of the large-size contracts borne by the Company. However, some other players have got some long-term/large contracts. Why is it so that when the industry's scenario is favourable and the Company's balance sheet is strong that in the last three years, we have not heard much about long-term contracts. Three years ago, the Company was very positive about winning many such contracts in the future. Is it that – the industry's scenario is changing, is the Company not interested in winning long-term contracts or do the customers have any other opportunities/many options to give large contracts to?

Rajendra Gogri: No, as mentioned already, there are ongoing discussions. Due to COVID, I thin]k you have to virtually forget one year from the calendar, because globally the demand was significantly impacted for a lot of items. That also resulted in a delay in the investment plan; everybody was trying to manage the existing business due to COVID, rather than going in for further investments and demand. Thus, that is also one of the reasons why we have not announced a significantly large contract. However, definitely, going forward I think it will happen.

Rohan Gupta: Can we expect that over the next 1-2 years, given that the pandemic scenario has subsided now, to hear on some large contracts for the Company; would you be in advance stages of any such discussions?

Rajendra Gogri: Yes, that is our endeavour. However we cannot announce these till they actually happen.

Rohan Gupta: Would the Company be in any advanced stages of such discussions that could be expected over the next 1-2 years?

Rajendra Gogri: We cannot make such forward-looking definite statements, but that process is on.

Moderator: The next question is from the line of Surya Patra from PhillipCapital.

Surya Patra: The question is relating to the first contract, because of which, in every quarter, the Company is building an additional income of ~$ 5 million. Is this just to cover the kind of underutilised cost of the new plant, which has been created at ~Rs. 400-odd crore and is it sufficient to cover all the overheads of that new plant or it is much below the potential fixed cost a plant of this size could be having?

Rajendra Gogri: No, it is definitely more than the fixed cost.

Surya Patra: It was mentioned that there is some impact in the margin because of the uncovered overheads in the first contract. Does this mean the plant for the first contract that has been created here is what we are seeing?

Rajendra Gogri: It is more than the fixed expenses, i.e., expenses which are larger than fixed expenses.

Surya Patra: Is it possible to quantify the extent to which there is pressure on the margin because of the plant which is not getting utilised currently? Related to this, despite the Company being one of the most integrated players, still it would not have seen much progress on that plant front. Would this be because the plant is currently in the validation phase or it is validation by the customers; when could we see the ramp up in that facility?

Rajendra Gogri: Basically, correcting on validation; the ramp up will happen from the second half of this year, in FY23 and FY24.

Surya Patra: You mentioned about the peak potential from this plant; would you capture the almost optimum utilisation of this plant by FY23?

Rajendra Gogri: Not in FY23, it will be more in FY24.

Surya Patra: Did you see any impact, because of the second wave of COVID, in implementing these multi-year projects? I think that the CAPEX for the second and third contracts would currently be under various stages of implementation. Is the timeline for commercialising those projects getting impacted?

Rajendra Gogri: Since second wave was very ferocious, the effort was to mainly keep operations running. We had good success there, but the projects across the board at various locations were impacted; the project timeline is extended virtually for all the projects.

Surya Patra: What would be the revised timeline for commercialising the second and third projects?

Rajendra Gogri: The second contract is targeted for Q3 and the third, for Q4.

Surya Patra: Not much difference in terms of timeline than what the Company had earlier mentioned then?

Rajendra Gogri: It is similar but might be pushed by one quarter. We are targeting to do it in Q3 and Q4, but maybe, this may take a longer time.

Surya Patra: About the cost elevation situation that we are seeing in the industry – do we need to worry about higher logistics costs, higher input costs and possibly the extended underutilised assets that the Company will be having for the new projects? How should we see in terms of those impacting the margin in the next one year or so/till the time the impact of COVID would be there?

Rajendra Gogri: For the raw material cost we have a pass through model which we have been highlighting. We have also been able to pass on the ocean freight cost because it is a very normal global phenomenon; a substantial portion of ocean freight increased. Somewhere we also have to bear the ocean freight costs. Other impact which is there is that the coal price also significantly increased. That is where some impact will come on us also. Overall, we have been able to pass on the raw material and the freight to the customer.

Surya Patra: In this quarter, was there any inventory gain? Would it be because of the speciality side or because of Pharma side; any specific reason that the Company is witnessing a kind of larger inventory situation for Pharma?

Rajendra Gogri: No, as you mentioned, container availability has become a big issue. For logistics there are two impacts – on actual exports and the price increase. So, there is lot of accumulation of finished goods inventory for both Speciality Chemical as well as Pharma. That is why there is an inventory gain against the inventory gain because of the price increase; part of that is offset by increased finished goods inventory, also some of the raw material cost increase happens with a quarterly lag. Thus, overall inventory impact is not significant.

Moderator: We take the next question from the line of Aditya Khetan from Stewart & Mackertich.

Aditya Khetan: On the opening remarks and continuing with the earlier participant's question, it was highlighted that in the pharmaceutical business some of the high-cost product inventories could not be shipped, that has led to a decline in margin. Has that issue been solved or are you still facing shortage of container and higher freight cost?

Rashesh Gogri: That issue has been solved. Basically, there has been lag in dispatches of products particularly going to US and Latin America, as you know the container availability has really become an issue. I believe that in July, we were able to clear out the inventory significantly.

Aditya Khetan: You were already guiding for additional capacity expansion in the API and intermediate speciality and it is expected to be operational in the second half of this fiscal year. If you could highlight the capacity that is being increased, just a ballpark number?

Rashesh Gogri: In terms of intermediates, we have started one manufacturing block where we have added around 150 KL of capacity already has started in the last quarter. In the API, we are adding one additional block, so that will get started in the second half of this year. So that will add significant capacity. There are also various other debottlenecking expenses that are under way in the API facility which will operationalise in the second half of this year. Overall, our capacity of API manufacturing will almost be 50-75% more, depending on the product-mix that we operate.

Aditya Khetan: So, 150k you mentioned in the intermediate?

Rashesh Gogri: Yes, 150 KL.

Aditya Khetan: On the second contract of Rs. 10,000 crore, I believe we already have a tie-up with customers, so when would the ramp up to peak utilisation happen?

Rajendra Gogri: In a couple of years, there will be a full ramp up of that plant.

Aditya Khetan: By FY24 you mean to say, or by FY23? Since we already have a tie-up with the customer, I do not think that it should take more than a year. Are you guiding by FY24?

Rajendra Gogri: We will have a structure in place by FY23 itself.

Aditya Khetan: On the first contract which was terminated, so then it would take till FY24.

Rajendra Gogri: Yes.

Aditya Khetan: This was asked earlier, on the gross margin contraction, if you look on a sequential basis, it is quite small – i.e., only 14 basis points, despite having seen some sharp increase in the major raw material prices like Benzene. Has the finished product price increase been significant that it offset some of the major raw material price increase; what happened that led to only a small decline in the gross margin this quarter?

Rajendra Gogri: We have had the raw materials pass through. A lot of the raw material price increases get passed on in the same quarter to the customer. Also, because of higher volumes which also benefitted to give a little more on margins. That is why the impact on our margin is less.

Aditya Khetan: So, it is only for the same quarter that the Company passes on, because earlier you used to guide that it takes a lag of 3-6 months; but now it is able to pass it on in 1-2 months only?

Rajendra Gogri: The local pass on is in the same month itself. For exports some of the passing on happens with a quarterly lag and that continues to be there now as well.

Aditya Khetan: What would be volume numbers for the quarter?

Rajendra Gogri: About 9-10% volume growth QoQ in Speciality Chemicals.

Aditya Khetan: Individually if you can highlight for Nitro Toluene for NCB?

Chetan Gandhi: Nitro Chloro Benzene, the volume was 18,155 metric tonnes, for Nitro Toluene it was 3,440.

Aditya Khetan: And Hydrogenation?

Chetan Gandhi: Hydrogenation was 2,920.

Aditya Khetan: And PDA?

Chetan Gandhi: In PDA, we would have got a run rate of over 570 tonnes per month.

Moderator: The next question is from the line of Chetan Thacker from ASK Investment Managers.

Chetan Thacker: Would the long-term contract start contributing in FY23 now and without any meaningful contribution in FY22?

Rajendra Gogri: No, the second contract will be commissioned in the second half of this year; some benefits will come in this year also, but it will not be significant.

Chetan Thacker: The large part will happen in FY23, that will be the fair understanding, for both the contracts?

Rajendra Gogri: Yes.

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

Rohan Gupta: On contract one for the Dicamba intermediate – in the last quarter conference call you mentioned that you are looking for some open opportunities or open market customers to sell these intermediates to which otherwise you were supposed to Bayer. You were expected to start routing this plant at almost 15-20% capacity for FY22, any breakthrough on getting the customer for that?

Rajendra Gogri: Basically, the major volumes we have to start in FY23.

Rohan Gupta: Have we started getting customers for that?

Rajendra Gogri: We are already in touch with a customer and some volume will start in this year. The major volumes will come in FY23.

Rohan Gupta: These customers, I believe, will be open market or global players, with them would the Company have a kind of an annual arrangement in terms of the offtake?

Rajendra Gogri: We will have some arrangements which would be of a longer term.

Rohan Gupta: Will there be many customers for these products or only 1- 2 customers taking a large quantity?

Rajendra Gogri: There are not many players but there will be a few players in this.

Rohan Gupta: About 3-4 customers, right?

Rajendra Gogri: Yes.

Rohan Gupta: I was seeking more clarity, there may be 3-4 customers for that product.

Rajendra Gogri: There are a few players in that sense. We will see as to how many customers we will be tying up with.

Rohan Gupta: With them, would the pricing arrangement be on the spot market and what kind of margins would you see in the longer term, on that product?

Rajendra Gogri: Basically, some sort of a structured pricing will come into place that we are looking.

Rashesh Gogri: We will have a structured pricing and these contracts are still under discussion. We will have more once we are able to finalise one in the next few conference calls.

Rohan Gupta: Can we expect a 55-60% of the capacity utilisation to happen from this intermediate in FY23?

Rashesh Gogri: We would like to say 100% also but we will let you know once we reach there as that cannot be answered today.

Rohan Gupta: On the second contract – You mentioned that a large part of revenue will definitely come in FY23, except that there may be some small revenues that come in the current period. Would this have any major impact because we were expecting ~Rs. 200-250 crore of revenue to come in FY22 from this second contract. Is there going to be any significant change in the overall financial outlook for the current year and can it be compensated by other products, i.e., the loss that the Company saw in contract two?

Rashesh Gogri: If we were to operate only for the second half, the revenue expectation for the full year would not be achieved. Thus, there will be some lower revenue from the second contract for this financial year.

Moderator: We take the next question from the line of Naushad Chaudhary from Systematix Share.

Naushad Chaudhary: On the Toluene chain – how much has the Company spent so far on this and what would be the revenue generated in FY21 from this chain? What is the potential that can be generated from this chain now?

Chetan Gandhi: The spend on this project for the Toluene chain – Toluene and Ethylene Derivatives both put together, would be around Rs. 200 crore which would have been invested from an overall basis on the project.

Rashesh Gogri: Last year in total we produced 13,000 tonnes of Nitro Toluene and derivatives were close to 500 tonnes per month.

Naushad Chaudhary: On the base shortfall fee, I think the Company has accounted for ~Rs. 170 crore as of now, cumulatively in the last 4-5 quarters. How much cash would we have received for this by now and are there any developments or negotiations with the clients on this; is the Company okay with receiving all the amounts which had been disclosed earlier?

Chetan Gandhi: From the time we got the termination notice, there was an amount of revenue which was getting accrued, so in last fiscal US$ 20 million was accrued. This we have received entirely. In this fiscal, the accrual will happen as per the contract's structured method. The settlement for that will happen towards the end of the year in the last quarter itself. Till that time, we will not have any cash which would be coming in on that basis. We are looking at things in terms of what more opportunities can be developed. Bayer is a very large customer and there could be various opportunities, but none of that is correlated with this.

Naushad Chaudhary: On the Pharma margins – in the last quarter, it was mentioned that there was some maintenance CAPEX cost which had impacted the margin. Also in this quarter, if I see, there is a favourable improvement in terms of capping prices. Given that the cost which we would have borne last quarter, because the maintenance was not there in this quarter, plus there was an improvement in capping prices. Apart from the raw material prices or the order which we could not dispatch in this quarter, was there something else which has taken the Pharma margin down.

Rashesh Gogri: No, it depends on the product mix, quarter-to-quarter depending on the product orders we keep on changing the product mix and every product may not be manufactured in our API plant every quarter. That can also have some impact on the overall contribution that we generate from these products, because certain products are highly profitable and if we make the product in particular quarter so that product can go up a little bit. It is just that aberration in the numbers, but overall, I think we are confident about what we are doing and we will have the growth.

Naushad Chaudhary: On not being able to deliver the high margin product; if the Company is not able to deliver it, it would not come to the P&L. So, there will not be any impact on margin, right? If it is stuck at the port site, then it is okay but had it been at your factory and you were not able to dispatch it, you would not account it in the P&L, so it would not have any impact, right?

Rashesh Gogri: It is the impact of both basically, the product mix impact as well as this.

Moderator: The next question is from the line of Yogesh Patil from Reliance Securities.

Yogesh Patil: You have maintained the gross margins at the same level on sequential basis. Is that correct since you have passed on the increasing raw material cost like Benzene to the customer fully or is some part of it remaining?

Rashesh Gogri: The domestic customers and export customers have different tenures by which the cost pass on happens. For the domestic customer it is plus one month and in the export it is plus one quarter depending on the contracts that we have. So, there is always a lag of price pass through.

Yogesh Patil: In which segment are you more confident to pass on the costs?

Rashesh Gogri: It is in Speciality Chemicals that we are more confident about the passing on of the costs whereas in Pharma there could be certain contracts which are annual in nature also.

Yogesh Patil: The reason for asking is related mostly to operating profit margins, is there any possibility to cross the 24% mark in the coming quarter?.

Rashesh Gogri: As the raw material prices go up and the top line increases further and further, the operating margin in terms of percentage goes down. So, in terms of absolute value, we can have some number. However, in terms of percentage, it is corelated to the top line and is a little difficult to have higher numbers with high raw material prices.

Yogesh Patil: During the quarter, the Company’s finance cost increased by 51% YoY. Is this only due to FOREX related losses of Rs. 13 crore or are there other costs involved?

Chetan Gandhi: This is purely because of FOREX-related, mark-to-market impact coming out of hedge accounting. If you look at the last financial year, when the Rupee was appreciating, there was a gain which was also provided in a similar manner.

Yogesh Patil: What is the net debt level expected to be by the end of FY22?

Chetan Gandhi: I guess the net debt level will be difficult for us to take a guess at because the raw material prices seem to be moving upwards. However, at constant prices the debt should be in the range of around Rs. 1,600-1,700 crore kind of value.

Yogesh Patil: You mentioned Rs. 1,600 crore as the net debt, am I right?

Chetan Gandhi: As of March 2022, that is what we are targeting.

Moderator: The next question is from the line of Bobby Jayaraman from Falcon Investment Advisors.

Bobby Jayaraman: Over the past few quarters and years, the Company has certainly been growing but you are constantly in need of capital. What is your prognosis for the next few years? When will you be internally self-sufficient from your growth?

Rajendra Gogri: Basically, these three years we have lined up Rs. 4,500-5000 crore – partly to be funded by internal accruals, partly QIP and partly debt. It will be based on the amount of investments; it will depend on whether we will need additional debt. However, for the next three years, there will be substantial CAPEX so we will have additional debt also.

Bobby Jayaraman: In terms of becoming free cash flow, is that one of your goals or at this point you see a lot of opportunity and you are not thinking about that?

Rajendra Gogri: I think that the Chemicals' industry is showing significant growth opportunities. Because we are also totally backward integrated and have very wide end use exposure i.e., from agro chemicals to engineering polymers, pigments and pharmaceuticals, the opportunities that we see for us are tremendous. At least we will be continuing to be in the CAPEX mode, and we are not looking at any free cash flow situation for the next 5-7 years.

Moderator: We take the next question from the line of Dhruv Muchhal from HDFC AMC.

Dhruv Muchhal: Just one clarification, you gave the volume numbers. As I add up the individual volume numbers or even look at the NCB key product chain, I do not see a QoQ 9-10% volume growth, what you commented in one of the earlier questions. What could I be missing here?

Chetan Gandhi: What we have given is just a base, i.e., some numbers on the key capacities where there are a lot of value-added products and lot of downstream products which come in. Thus, you will have to compare all of that to get to the right number. These are only few of the products from the entire basket of products that we have.

Dhruv Muchhal: But this would be the upstream of it – so if the upstream comes the downstream will come. So, is it not fair to compare just from the upstream level? Is that not the right comparison?

Rajendra Gogri: Generally, when we do the comparison, we do to see if there is any change in the top-line, we do it for a complex, weighted volume increase. These are specific product volumes but when we want to do at the entire segment level, we arrive at a number which is on a weighted basis.

Dhruv Muchhal: So, the 9-10% is on a weighted basis.

Chetan Gandhi: Yes. Like for instance in case of Nitro Toluene or Hydrogenation, the volume growth on a QoQ basis is like 20%, 50% so you will have to look at even the downstream for those and then see on that basis how it adds up.

Dhruv Muchhal: So, you do a value-to-volume weighted based calculation. If you can provide this number on a consistent basis, it would be very helpful, just to understand how the trend is moving as otherwise these volume numbers just give us some sense, but not the complete sense because otherwise it looks like on a QoQ basis the volumes have not grown much.

Moderator: The next question is from the line of Arun Prasath from Spark Capital.

Arun Prasath: We see that there is a very high price for glycoside in many places which could be taken as a substitute for Dicamba. Are you seeing any strong demand for Dicamba due to this?

Rajendra Gogri: Yes, we are seeing some revival with the increase in Dicamba demand compared to what was spoken by the customer.

Arun Prasath: If you can quantify, what was it earlier and what is now?

Rajendra Gogri: In general, they have indicated that demand has become stronger.

Arun Prasath: What is the scenario on the regulatory side of Dicamba, the Company had earlier seen some challenges, especially in the US market?

Rajendra Gogri: They got the approvals. There are no regulatory challenges.

Arun Prasath: On the cancellation that happened because of the earlier regulatory challenges, it could also get reversed so why is the Company supplying it in the open market? Can we not go back to the same customer and ask them to take our products?

Rajendra Gogri: The cancellation did not happen because of regulatory reasons. They were supposed to put up their plants to manufacture in US and then decided to stop the construction of the new plant. It was not routine, it was an overall assessment that they had done, that instead of manufacturing the finished agro chemicals themselves, they would like to buy that molecule from India and China, that was the strategy, different and not connected to the regulatory issues.

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

Abhijit Akella: What is the reason for the decline in other unallocable expenditure this quarter. It is down from Rs. 59-60 crore in Q4 to about Rs. 39 crore this quarter. So, just wondering if there are any one-off items there; how should look at this going forward?

Chetan Gandhi: There are some reductions in the operating costs which were there in the earlier phases for managing logistics and such. So, some of those costs have gone down and we found bit of a benchmarking of allocating couple of cost to specific segment. So that is where the change has happened.

Abhijit Akella: On a quarterly run rate basis, this is the right number to trend as of now going forward?

Chetan Gandhi: Going forward we can start using this kind of numbers.

Abhijit Akella: On the volume numbers that were said for Nitro Toluene, you said 3440 tonnes. Does that exclude the downstream products?

Chetan Gandhi: These are only the Nitro Toluene volumes, not the downstream ones.

Abhijit Akella: On the new projects that are getting commissioned any sense of the turnover that we expect from the major project out of these – you mentioned, for example, Chlorination or the Dahej phase two, NCB phase two, etc.?

Rajendra Gogri: Actually, we had guided that from FY21 to FY24 about 1.7 to 2 times turnover. So, from Rs. 5,000 crore turnover is what we had in FY21, we are looking at ~Rs. 9,000 crore turnover by FY24.

Moderator: The next question is from the line of Pratik Rangnekar from Credit Suisse.

Pratik Rangnekar: On the guidance that you have given us of 25-35% growth in FY22. Now, if we are talking about some delays in the long-term contracts, then that essentially means that the base business will actually have to grow much faster and even on an adjusted basis, we have kind of hit a run rate which is similar to Q1 FY20 in the Spec-Chem business in the core if we exclude the compensation and all of that. Is there anything in particular which you are seeing, which is driving an acceleration in growth in the core business?

Rajendra Gogri: This second and third contracts, the contribution was not significant in our guidance of 25-35%. Some delay in the commissioning is not going to impact much.

Pratik Rangnekar: Maybe if I can frame the question a bit better. Is there anything in the underlying business, any particular segment or any particular geography or any particular customer product that you are seeing which is ramping up to drive this 25-30% growth? Because even after we cover for the low pay, it is a much stronger growth compared to FY20, compared to what we have seen.

Rajendra Gogri: Last year the volumes, EBITDA and PAT, were all impacted because of COVID in the first half. The second half was much stronger, and we will be building on that. We see that most of the demand of the pre-COVID levels has been reached and in some of the segments the demand has grown even more than the pre-COVID levels. Based on that we are seeing good volume growth possibility.

Pratik Rangnekar: In terms of volume trend, what is the number that you could look at this quarter, like in terms of a sustainable volume growth over FY20, if one was to look at that, not FY21.

Rajendra Gogri: FY21 basically that is what we have said, 25-35%, so that is the overall guidance we see.

Pratik Rangnekar: I will take that offline. The next question that I had was that there has been a lot of discussion on the cancelled long-term contact. Maybe if you could throw some light on what the challenges are that you are facing in ramping that up? Because one would have assumed that it would have been faster than what you are currently guiding for say FY24 because we have a large part of the intermediate capacity on that product. Right?

Rajendra Gogri: Overall the demand of that product was impacted. So, this year it will be more of a qualification and significant demand is expected only from the next year for this product.

Pratik Rangnekar: This is more like a regulatory hurdle that you face in terms of qualifying with the customer and once that is done, then the ramp up will be faster. Is that the right understanding?

Rajendra Gogri: Yes and the demand itself was impacted, because of that there is a lot of inventory in pipeline, i.e., accumulated inventory. That is why this FY22 demand is relatively less. More demand will come from next year.

Moderator: Thank you, Ladies, and gentlemen, that was the last question for today. I would now like to hand the conference back to the management for closing comments.

Rajendra Gogri: It has been a pleasure interacting with you over the call. Before we close the call let me reiterate that with the execution of our planned growth objectives, we look forward to driving strong value for all stakeholders associated with Aarti Industries. We thank you for taking time out and engaging with us today. We value your continued interest and support. If you have any further questions and would like to know more about the company, kindly reach our Investor Relations desk. Thank you.

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