AARTI INDUSTRIES LIMITED

Aarti Industries Limited

Q1 FY 2020 Conference Call Transcript
August 14, 2019

Moderator: Ladies and gentlemen, good day and welcome to the Aarti Industries Q1 FY 2020 Earnings Conference Call. As a reminder, all participant 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 please signal an operator by pressing "*" and then "0" on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Shiv Muttoo from CDR India. Thank you and over to you, sir!

Shiv Muttoo: Thank you, Raymond. Thank you, everyone and good evening today and thank you for joining us on Aarti Industries Q1 FY 2020 Earnings Conference Call.

We have with us, Mr. Rajendra Gogri -- Chairman and Managing Director; Mr. Rashesh Gogri -- Vice Chairman and Managing Director; and Mr. Chetan Gandhi -- CFO of the company.

Before we begin this 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 that effect has been included in the results presentation shared with all of you earlier.

I would now like to invite Mr. Rajendra Gogri to take you through the performance of the company and his outlook on the business. We will then have the forum open for an interactive Q&A session. Over to you, sir.

Rajendra Gogri: Good evening and very warm welcome to all of you. We have started FY20 on a strong note recording profit after tax of Rs. 137 crore on stand-alone basis. This is the highest ever profit in our operating history till date. We concluded the composite scheme of arrangement between Aarti Industries, Aarti Surfactants Limited and Nascent Chemical Industries Limited during the quarter. Reported revenue from operation was up 1% Y-o-Y, impacted by decrease in raw material prices and ceasing contribution from HPC business. Adjusted for the demerger of HPC business, revenue is up 8.8% Y-o-Y.

Our absolute EBITDA, which is a key metric to track our relation linked to global crude oil prices grew 26% Y-o-Y in Q1 FY20 to Rs. 237 crore. EBITDA margin expanded 440 bps Y-o-Y to 21.8% on account of expanding contribution of higher-value product and better operating leverage.

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The Specialty Chemical business expanded revenues by 5% Y-o-Y; however, after adjusting for the impact of raw material prices, at constant raw material prices, the revenue growth for the segment was 9.44% Y-o-Y.

EBIT margin expanded 500 bps Y-o-Y and 70 bps Q-o-Q to 22.5% in Q1 FY20. Contribution from downstream products further increased to 72% from about 70% a year ago, indicating a higher value addition of downstream products in the mix and bringing a substantial rise in both contribution margin and operating margin. We have successfully leveraged our large range of product offerings and fungible manufacturing facilities to optimize our product mix towards high-margin products, resulting in higher EBIT, despite a lower volume growth.

We produced about 16,103 metric tonnes of Nitrochlorobenzene during Q1 FY 2020, as against 17,000 metric tonnes for Q1 FY19 and 15,807 metric tonnes for Q4 FY19. As you are aware, we are in the process of further expanding NCB capacity from 75,000 tonnes per annum to 108,000 tonnes per annum to cater to increasing domestic demand and also for downstream captive requirement. The capacity addition would come up in two phases, Phase I in FY 2020 and Phase II in FY 2021, and entail an investment about Rs. 150 crore. We achieved over 75% capacity utilization for our ethylation unit in Dahej SEZ at the end of Q1 FY20.

The pharma-based business delivered a robust revenue growth of 28% Y-o-Y. EBIT margins remained steady at 16.7% as compared to 17.54% in Q1 FY19 and 13% in Q4 FY19. The segment performance has improved on the back of higher capacity utilization and our focus on high-growth product baskets, such as Xanthene derivative and pharma intermediates in regulated market.

We have continued to execute on our capex plan and have invested about Rs. 238 core in Q1 FY20. Our planned annual capex for FY20 is expected to be in the tune of about Rs. 1,000 crore to Rs. 1,200 crore.

The major ongoing project is a specialty chemical complex and chlorination plant in Jhagadia in Gujarat, which should be commissioned in coming quarter and CAPEX-related project at Dahej is expected to be commissioned by end of the year. Other projects include API and pharma intermediate debottlenecking and expansion in Vapi and Tarapur. We are also in the process of setting up our fourth R&D scale of unit at New Bombay that will facilitate further enhancement of product portfolio and also help to improve our manufacturing processes.

Given the strong performance and profitability delivered over the past few years and in appreciation of the continuing support from our shareholders, our board of directors recommended the issue of 1 bonus share for every share held by them, subject to the approval of shareholders of the company. This may also lead to increase in the liquidity available for the shareholders.

To conclude, this has been a good start to the year in a challenging global macroeconomic environment. We have developed a diversified and de-risked portfolio comprising about 200 products that are marketed to more than 400 global customers in over 60 countries and 700 customers in India. Our top 10% and top 20% contribute 27% and 38% to the total revenue, respectively. The company is also benefiting from its deep relation with domestic customers, who are setting up for expanding capacity and downstream product, as a structural shift of global demand continues to favor consistent Indian suppliers.

However, factors such as prolonged tariff and trade discussion, evolving global equation, constantly evolving China factor, political instability, extreme weather events, etc, creates uncertainty. These are creating some near-term weaknesses in the agrochemical and automotive sector in some key global geographies. We will be continuing to monitor the situation closely and take necessary actions as may be deemed necessary. In the interim, taking a conservative view, we expect growth in profits to be lower than earlier guided by us during the last concall. Overall, our intrinsic business strength allows us to negotiate any short-term impact from weakness in the operating environment, while long-term growth parameters and competitiveness remains largely intact.

On that note, I conclude my opening remarks. We will be very happy to give you our perspective on any questions that you may.

I will request the operator on this call to open question-and-answer session. Thank you.

Moderator: Sure. Thank you very much. We will now begin with the Question-and-Answer Session. The first question is from the line of Sneha Talreja from Edelweiss. Please go ahead.

Sneha Talreja: It was more pertaining to how much has been the volume growth in the current quarter for your specialty chemicals division?

Rajendra Gogri: Yes, at constant raw material prices, the growth was 9.4%.

Sneha Talreja: That is the volume growth?

Rajendra Gogri: Now we are working out not on absolute volume growth but at a constant raw material prices, what is the revenue growth, which is at 9.4%.

Sneha Talreja: Okay. And sir, you said in the initial remarks that you were seeing some kind of a slowdown in the agrochemicals and the automotive space because of which you are lowering the guidance compared to last quarter. Have you given up any number or I have missed on the same?

Rajendra Gogri: No, we have not given any number. Basically, it is still an evolving situation. So, any revision or we may give after Q2. But overall, it seems to be that it will be lower than what we had guided earlier.

Sneha Talreja: Okay. Sir, can you just highlight the sense that you are getting from your customers, in which all spaces are you seeing more of a slowdown?

Rajendra Gogri: Basically two sectors, certain agrochemical especially in the U.S. because of the weather situation, agrochemical as overall even acreage also has reduced this year in agrochemical usage. And automotive sector, I think, is globally impacted whether it is China, India. So, these are the two major sectors where the impact is there.

Moderator: Thank you. The next question is from the line of Ritesh Gupta from Ambit Capital. Please go ahead.

Ritesh Gupta: Thanks for taking my question. Just one quick clarification, you said the volume growth rate was 7.9% in the quarter or 9.4% in the quarter?

Rajendra Gogri: 9.4%.

Chetan Gandhi: So, what we have done is as discussed last time in our business now the volume growth has its own set of challenges because there is a significant shift of product profile towards a high-value and higher-margin profile product, where the volumes are relatively lower. So, as discussed last time, we probably look at comparing it at constant raw material prices what is the revenue growth, which would be the combination of a product mix driving the higher contribution as well as the volume growth. So, the revenue growth as constant raw material price is close to around 9.4%.

Ritesh Gupta: Okay. And that is what you are saying that is in a way volume plus mix kind of a growth.

Management: Yes.

Ritesh Gupta: Okay. And just on the slowdown bit. Is it that on the agro side, clients have already started to indicate you there is a slowdown in the demand? Is there a direct communication that you have got from some of your clients? Or is there something which is basically more cautionary wherein you read the same thing as what we read and kind of that is more cautionary in nature?

Rajendra Gogri: No, the impact is already seen. We are getting the feedback from the clients because the actual usage this year, especially in the U.S., has been lower.

Ritesh Gupta: Got it. And Latin America is not able to make up for that is the understanding?

Rajendra Gogri: Yes.

Ritesh Gupta: Okay. And sir, just on the improved profitability bit, I mean, I understand that there was some mark-to-market losses sitting in the other expenses last year same quarter. So, if you could just give us a sense, I mean is it I understand those are hedge, gains and losses, but if you could just take us through the nature of these losses and remind us on that?

Rajendra Gogri: In last year, basically, we maintain a hedge book. So, last year the currency was very volatile. So, on the hedge book, we had an impact of close to Rs. 29 crore on the hedge portfolio, which we were maintaining for the exports orders that we have.

Ritesh Gupta: Okay. So, that basically gets reversed as and when the hedges kind of unwind?

Rajendra Gogri: Yes.

Ritesh Gupta: Okay. And just on the capex bit, could you just remind us which are the key projects on which this money is going to be spent?

Rajendra Gogri: The major ongoing project is a specialty chemical complex and chlorination plant in Jhagadia in Gujarat, which should be commissioned in coming quarter and capex for long-term contract at Dahej, expected to be commissioned by end of the year. Other projects include API and pharma intermediate debottlenecking and expansion in Vapi and Tarapur. We are also in the process of setting up our fourth R&D scale-up unit at New Bombay that will facilitate further enhancement of product portfolio and also help to improve our manufacturing processes.

Ritesh Gupta: Okay. And just on the other expenses and employee cost side, if I adjust for the mark-to-market losses, I think other expenses increased by 34% and employee cost was also up by about 30% Y-o-Y. So, like, I think gross profit growth was pretty decent at 20% odd. So, if you could just take us through, I mean, what is driving these changes? Just the new plants which are being added and kind of new capabilities that you are adding in R&D? Or is it something else also? Or is there something one-off in this numbers?

Rajendra Gogri: No, basically, overall, we are building a stronger team looking at the long-term requirement. So, that is increasing the employee costs. And other expenses, I think because of some merger the nascent chemical merger also comes into the picture in standalone. That is one of the reasons.

Chetan Gandhi: Yes, and then other swing would be normally linked to inflationary changes during the year and other stuff.

Ritesh Gupta: No, but even then, I mean, 30% growth versus, let us say, 20% gross profit growth, I think will be more than inflation. So, basically, saying that new capacity addition and employee cost addition is what you are saying?

Chetan Gandhi: Yes, the other expense actually increased by about 10%.

Ritesh Gupta: No, so if I adjust for that hedge book impact of Rs. 29 crore…

Chetan Gandhi: Hedge book is from the revenue, sir, not in other expenses.

Moderator: Thank you. The next question is from the line of Nav Bhardwaj from Anand Rathi. Please go ahead.

Nav Bhardwaj: Few questions. Number one, in order to get a like-for-like comparison, can you share as to earlier what would be the part of the expenditure on raw materials for the HPC segment in the previous quarter won by few others?

Rajendra Gogri: The EBIT, earnings before interest and tax for the HPC segment was Rs. 1.99 crore. I do not have the breakup right now with me in terms of the raw material and other stuff. But the overall EBIT, if you just compare the EBIT, the EBIT contribution last year of the HPC segment was around Rs. 1.99 crore. So, you can just reduce that from the previous year numbers just to have a like-to-like comparison.

Nav Bhardwaj: Okay, all right. And also on the Nascent front, I remember you sharing that the company had pretty decent margins, much above Aarti as a company earlier. Now post-merger, since we are going to be completely owning it, is there going to be some kind of an absorption of the margins? Or is it going to be remaining at the same for the company as a whole right now?

Rajendra Gogri: It was very small, actually. If you see what the number of shares which has been issued only about 4 lakhs - 5 lakhs. So, overall, in Aarti's balance sheet it is not going to be a huge impact as such.

Nav Bhardwaj: Right. And also, in terms at the end of the year, what kind of capitalization into a gross block can we see, based on the run rate of the capex that is going on right now?

Rajendra Gogri: Yes, I think substantial part will get capitalized. First quarter, we capitalized only about Rs. 70 crore. But at least around more than Rs. 700 crore - Rs. 800 crore, I think, will get capitalized by end of it.

Nav Bhardwaj: Also, if you could add as to what kind of increment or contribution to EBITDA must have come from the increase in prices if at all there was in PDA prices due to the recent event?

Rajendra Gogri: It will be more, I think, about Rs. 10 crore or so.

Moderator: Thank you. The next question is from the line of Abhijit Akela from IIFL. Please go ahead.

Abhijit Akela: First of all, just a clarification on the previous point you made, sir, about the price impact of Rs. 10 crore. Is this the impact on the entire portfolio of products? In other words, I mean the benefit due to increased prices across the entire portfolio of products was Rs. 10 crore?

Rajendra Gogri: No, it was specifically for this PDA line.

Abhijit Akela: Okay. For the overall portfolio, you have been sharing some numbers, sir, in the past. So, if you can share something?

Rajendra Gogri: No, that was last year basically, what we have seen that abnormality about 10% last year. Last year, overall, we had substantial increase over FY18 in FY19. At that time, it was about 10% increase and part of that was corrected in last year also and this year also some correction has taken place. So, this year, one of the major impact is continuing is the PDA line.

Abhijit Akela: Okay. Otherwise, prices are close to normal?

Rajendra Gogri: Now, other prices are virtually getting normalized.

Abhijit Akela: Right. And sir, just on the PAT growth guidance that you provided. If I just take this quarter's profit, standalone profit of Rs. 137 crore, and I assume even just a normalization assume that the same run-rate continues throughout the year for the four quarters, it would still lead to about 17%, 18% net profit growth for the full year. So, given that you are moderating your guidance, should we assume that this quarter's run rate is a bit on the higher side? There could be a correction in the run rate going forward?

Rajendra Gogri: No, if you multiple four times, it will be more towards 12%, I think. Last year, we had Rs. 491 crore on an annualized basis. So, if you just make it 4 times then it comes to around 11% over the last year.

Abhijit Akela: Okay. I think that is consolidated.

Rajendra Gogri: No, you do not understand that is the revised standalone what we have filed. Yes, so 4 times, it takes it around 11% to 12%.

Abhijit Akela: Okay. So, you would think this run rate is at least sustainable for this quarter?

Rajendra Gogri: So, overall, we had given the guidance of 12% to 20%. So, now we see the 20% is something which does not seem to be visible. And same way, it can go below 12% also. Overall, the range will go downwards. That is what we are looking at.

Abhijit Akela: And you specifically mentioned agrochemicals and autos as two sectors of weakness. If you can just share some color in terms of agro? Are we catering more to the generic part of the market? And is that where the weakness is? Any specific product segments that you could talk about? And then similarly, in autos...

Rajendra Gogri: Agro, in U.S. has been impacted across the board. Because overall, the acreage of some of the products has gone down corn and soya and even in that acreage also the application of agrochemical has been lower. So, corresponding impact is coming as far as the agrochemical is concerned and automobile, I think, China is a major slowdown. Also India, but Indian market is relatively much smaller given that though the percentage in India is slowdown is higher. But overall, auto sector globally is impacted because of mostly China impact.

Abhijit Akela: Agro, our portfolio is mainly to the generic side, is it, sir, or...?

Rajendra Gogri: Yes, it is basically most of the products are generic.

Abhijit Akela: Right. And would this have any impact on the long-term contract at Dahej, which is for the herbicides? Would there be any impact on that at all or...?

Rajendra Gogri: No, this year, the impact is mainly because of this weather of the current year. So, I do not think, there will be any carry forward impact for the next year.

Abhijit Akela: Fine. One last quick thing, Ind-AS 116, could you just elaborate on the EBITDA benefit and the impact on depreciation and finance costs?

Chetan Gandhi: Sir, it would not be significant because we do not have such assets, which is majorly off balance sheet. So, Ind-AS 116 impact was I guess, Rs. 2 lakh - Rs. 3 lakh only.

Moderator: Thank you. The next question is from the line of Sagar Jetwani from Karvy Capital. Please go ahead.

Sagar Jetwani: My question was pertaining to our exposure with regards to the agrochemicals and automobile. Do you have any number what revenue is dependent on those two sectors?

Rajendra Gogri: No, actually, lot of our products have multi-users and some of that used may be in agrochemical and simultaneously, it uses for other products also and auto. So, same product goes into variety of sectors. But overall, agrochemical is around as a segment around 25% to 30%.

Sagar Jetwani: Okay. And for auto?

Rajendra Gogri: Automobile and aerospace and electronics and all these generally will be combined. There will be, what we call engineering polymers and all. It is not purely in auto because it goes in electrical, electronics, aerospace and also. That is around 20%.

Sagar Jetwani: Okay. So, this is overall revenue pie?

Rajendra Gogri: Yes.

Moderator: Thank you. Next we have a follow-up question from the line of Ritesh Gupta from Ambit Capital. Please go ahead.

Ritesh Gupta: So, just wanted to check another clarification, on this other expense thing also, I mean, you say that in the notes to accounts you go on to say that it is expense from the P&L. So, I am not sure if, like, it is expensed, how can it be expensed from the sales directly? I mean, it has to be through one of the cost accounts, right? So, it has to be either through other expenses or...?

Chetan Gandhi: No, sir, so the point is because it is related to an export contract, which are linked to the revenue, so the accounting standard requires it to be adjusted against the same. Now, that is how it is.

Ritesh Gupta: Okay. So, if I have to do it a like-for-like, then I have to adjust it in the sales rather than in other expenses? Is that what you are saying?

Chetan Gandhi: Yes, sir.

Ritesh Gupta: Okay. And on the agri bit only, I mean, on the agri and like the auto bit, is it the volume growth rate that gets impacted because of this demand slowdown? Or is it that the realizations kind of see an impact of the demand slowdown?

Chetan Gandhi: So, volume gets impacted and somewhere the margin also gets impacted, but volume will be the first thing which will get impacted.

Moderator: Thank you. The next question is from the line of Dhruv Bhatia from BOI Axa Mutual Fund. Please go ahead.

Dhruv Bhatia: Sir, my question is on the large contracts that are going to be starting from the end of this year. Because of the slowdown that you are seeing in the agrochemical sector, is there a risk to doing that type the revenue also from these large contracts?

Rajendra Gogri: No, we have certain structure in place in that. So, we do not expect any big impact of that. And as I mentioned earlier, this year the impact is mainly because of the weather conditions in U.S., which has led to the across the board reduction in the usage of agrochemical.

Dhruv Bhatia: And from the Europe geography, are you seeing similar type of slowdown or that is going as per your plan?

Rajendra Gogri: No, Europe we have not seen any impact in the Europe.

Dhruv Bhatia: Okay. And the contracts are I mean, the time line in terms of execution are on track?

Rajendra Gogri: Yes.

Dhruv Bhatia: All right. And sir, could you just tell us what the debt number is?

Chetan Gandhi: So, the debt number would be close to around Rs.2,150 crore.

Dhruv Bhatia: And cash is?

Chetan Gandhi: So, we still would have got close to around Rs. 300-plus crore, which we are yet to deploy in projects.

Moderator: Thank you. The next question is from the line of Abhijit Akela from IIFL. Please go ahead.

Abhijit Akela: The finance cost has come up quite significantly this quarter, so if you could just share some color on that, whether there is a good run rate going forward?

Chetan Gandhi: So, if you refer to the note#07 on the financials, so there is an income of around Rs. 6 crore, which was there because you have got the QIP proceeds towards the end of the March and we had to deploy it for the projects, which will have its own time line for deployment. So, there was certain interest income, which was received, which was netted off.

Abhijit Akela: Right. But adjusted for that also, it would have been around Rs. 36 crore, Rs. 37 crore.

Chetan Gandhi: Yes.

Abhijit Akela: So, is that the right number to work with now?

Chetan Gandhi: So, it should be around Rs. 36 crore, Rs. 40 crore kind of number.

Abhijit Akela: Right. And obviously, the QIP proceeds were planned to be deployed in growth projects. Now with this environment of slowdown in certain sectors, how do you see prospects of winning more multiyear orders? Do you think that, those plans get delayed by a few quarters? Or how do you see that?

Chetan Gandhi: So, the objects for the QIP were very clear in terms of the projects where we need to deploy the money. Those projects are continuing. There is no delay or challenge in terms of implementation of those projects and as Mr. Gogri said in the opening statement that we are committed to keep on engaging on the project activity and continuing the investment further. So, the macro outlook on a long-term basis still prevails and is still stronger from an India's position.

Abhijit Akela: Right. So, I guess, from a three years - five years perspective, the targets that we have talked about in the past of maybe 15% plus kind of growth, those still in place?

Rajendra Gogri: Yes, because overall India is emerging as a low-cost destination. So, we are seeing a huge appetite for sourcing from India. And I think, that will continue. Whatever the slowdown in auto and all that is a separate matter, but the chemical manufacturing and chemical requirements from India because Chinese labor cost is now double than India. And environmental costs are similar because now everybody has to be compliant whether they are in China or in India. So, inherently, there is a cost advantage in India, and also because of the risk-sharing customers want a supply chain, which is totally independent of China and that is where the company like us have a big advantage because we do not import any raw material from China for our chemical business. We are totally backward-integrated. So, lot of places now we are asked for the product, which value maybe starting from Benzene which is less than $1 to $30, $40, $60, $70 also. And that is where our additional investment in R&D activity is going to help us down the road for capitalizing those. But appetite is substantial appetite for backward-integrated chemical from India.

Abhijit Akela: Sir just last thing on that point itself, just to check. Given the substantial appetite and India's strengths, I mean, do you still see a possibility that new orders could still come to the company, even in this environment of a slowdown this year itself? Or would you think that customers have become more reluctant to engage on signing long-term contracts for now and they will wait for signs of resolution and clarity in the global environment before they sit down at the table and sign these contracts?

Rajendra Gogri: No, the entire process will always continue. The actual signing of the projects will depend on the exact timeline when they will require and all. But this is an ongoing process. Just because of this slowdown, we are not saying customer will stop engaging. It is still continuing, something which they may require after 12-month might get delayed to 15 months or 18 months. But still basically their requirement, their preference towards India remains and those enquiries are continuing.

Moderator: Thank you. The next question is from the line of Chirag Dagli from HDFC Mutual Fund. Please go ahead.

Chirag Dagli: Sir, have you seen this slowdown impact in the first quarter?

Rajendra Gogri: Not significantly, no.

Chirag Dagli: So, second quarter onwards, you will see full impact?

Rajendra Gogri: Yes, second. Maybe third and fourth might be more impacted.

Chirag Dagli: Okay. And sir, what will be the capex for FY20 and FY21?

Rajendra Gogri: FY20 is around Rs. 1,000 crore to Rs. 1,200 crore this year and next year will be within Rs. 500 crore to Rs. 700 crore, but ultimately depending on how we finalize projects. But that range will be definitely there.

Chirag Dagli: Okay, sir. And sir, if you can talk a little bit about the import substitution opportunity in intermediates. We were looking at this seriously. What has happened over there? If you can share some update there?

Rajendra Gogri: No, there are huge opportunities. We already have taken up lot of projects in R&D on that front also. As you know, this entire cycle is quite long, you have to do the R&D and then put up the project and all that. But we have identified products, which can be considered for putting up manufacturing and import substitute space also.

Chirag Dagli: How many products have you identified?

Rajendra Gogri: Absolute, number-wise entire 15-20 products kind of number.

Chirag Dagli: And this is across the chain of pharma, chemical, others as well? This is intermediates essentially?

Rajendra Gogri: This is on the chemical side.

Chirag Dagli: Okay. And if you were to think about this piece, say three years - four years out, do you think this can be a materially large business in the context of where we are or where we will be at that point in time?

Rajendra Gogri: Yes. Actually, what is going to happen, once you have those intermediates available in India, import substitute, you will see their consumption also will increase. It kind of becomes a catalyst when their product starts becoming available in India. So, in general, the entire supply chain is the more intermediate entire supply chain will further grow. So, that is what has happened now. Our domestic consumption market increased than earlier expectation.

Chirag Dagli: Sir, when do we see the light of revenues here, first signs of revenue here?

Rajendra Gogri: For?

Chirag Dagli: For these intermediates, import substitution intermediates?

Rajendra Gogri: It is about at least two years to three years.

Moderator: Thank you. The next question is from the line of Archit Joshi from Dolat Capital. Please go ahead.

Archit Joshi: I missed out on the NCB volume numbers that you gave earlier? And also, if you can share PDA and hydrogenation volumes this quarter?

Chetan Gandhi: So, NCB volume for the quarter was 16,100, which in Q4 was 15,800.

Archit Joshi: All right. And sir, PDA and hydrgenation, also?

Chetan Gandhi: PDA for Q1 was 446 tonnes per month and for Q4 it was 318 tonnes per month. And hydrogenation was close to 1,880 tonnes per month, which earlier quarter was 1,990.

Moderator: Thank you. The next question is from the line of Suryakant Patra from PhilipCapital. Please go ahead.

Suryakant Patra: Sorry, I missed the initial portions since I joined late. So, could be repeating the question. So, just wanted to know as you are mentioning that there is a likely slowdown, so are you cutting the current year's growth guidance, sir?

Chetan Gandhi: Yes, that is what we have said in the opening remarks, that earlier our guidance was 12% to 20%. We do not see going towards 20%. And this lower guidance 12% also may go down. So, the range is, basically, we see that the range will shift downwards. The band is 12% to 20% and the band will shift downward.

Suryakant Patra: Okay. Are you revising to what extent it will come down is it telling anything?

Chetan Gandhi: Overall, we see that it will be downward. No specific number, I think it is too early. So, maybe after Q2, we might be able to give more specific range.

Suryakant Patra: Okay. And on the specialty chemical sir, strong set of numbers, particularly the EBIT margin also, possibly highest in last three years, four years. So, where from that you are getting this? Why because since last two quarters, we have been seeing a kind of softening in the pricing trends for most of the key products. And despite that we have seen sequential improvement over last three quarters, four quarters in the EBIT margins. So, whether it is entirely flowing from the improving product mix? If yes, then can you just share couple of high-value products what you are talking about where you should be seeing improved margin scenario?

Rajendra Gogri: Yes, initially we had told, at constant raw material our specialty chemical revenue had grown by about 9.4% and the high-margin, which was witnessed in FY19 for a variety of products that has come down. But some of the products, they still remain. As we had said in the beginning, even the year end concall, so that extra margin products are kind of changing depending on the situation.

Suryakant Patra: Great. Okay. Any benefit that you have witnessed from the PDA side because of the kind of blast what we have witnessed in China recently?

Rajendra Gogri: Yes, we have seen about Rs. 10 crore more than anticipated.

Suryakant Patra: Okay. And sir, whether particularly in the press release also what you have mentioned in your presentation, rather, that there is a kind of meaningful demand visibility from marquee clients. So, if you can share what is the kind of trend that you are witnessing with your existing clients and with the new potential clients?

Rajendra Gogri: In general, basically, as I said earlier also that they want to de-risk from China. So, only China source is there, they want to add India as a source. And also, whatever maybe the growth requirement, they want to increase more and more sourcing from India. Accordingly, we are getting lot of inquiries. And on that basis, we are carrying on further development work.

Suryakant Patra: Is it more about growth, better growth in the existing customers supply or it is from the new customers that you are talking about?

Rajendra Gogri: Mainly existing. But now even the innovative pharmaceutical companies are also looking to diversify the supply chain, which is, those who are generally not worried about the pricing. But now they are worried about the supply chain, and they are also looking to have a supply chain which is totally independent of China.

Suryakant Patra: Okay. About the pricing trends, sir, how different that would be for domestic versus export product pricing? So, whether it is significantly different, it is similar or some sense on that? Or which is better, which is relatively lower?

Rajendra Gogri: It will be always product-to-product. Generally, when you are comforting on import parity then obviously in India the import duty benefit will come in. But some product the demand in India itself may be small and capacity for downstream product to x of the pricing may be lower. So, sometime pricing in India can be lower. In general, the Indian prices have to be higher.

Suryakant Patra: Okay. Just last one question, sir. On the pharma side, after delivering robust growth here this quarter and you are anyway guiding around 20% kind of growth for the full year, so whether any capacity constraints that you are having currently? And if you can revise your growth outlook there at least for the pharma for the full year?

Rajendra Gogri: Yes, yes, basically, last time also we have guided that the pharma will grow 20% to 30% top line. We have existing capacities, which is available to grow in current, and we are expanding both our API as well as intermediate manufacturing sites, their expansion and this expansion will get over in a year's time from now in different phases. So, we will have some plants, which will come for use in last quarter and some will come in next year second quarter. So, we have the new plants that are lined up for intermediates as well as API, which will bring additional capacity so that we can grow in next year as well.

Suryakant Patra: Okay. So, then for your API business, what percentage is backward integrated? And to what extent it is integrated? If you we can share that would be useful.

Rajendra Gogri: In our API, there are two segments that we produce: one is Xanthene and one is regulated APIs for U.S. and European market. Xanthene's are completely backward integrated. We have our own intermediates that we produce in-house and it is a four stage to five stage process that we do in-house. Whereas in the regulated APIs that we manufacture, we have other than steroid, all other intermediates are largely multi-stages being done in our in-house, intermediate plant. And we also sell this intermediate for outside other manufacturers which are big generic companies. The steroids are the one which we do not do because it involves fermentation that we are not doing currently.

Suryakant Patra: Okay. So, if it is that integrated, our EBIT margin in the pharma business is meaningfully lower compared to specialty chemicals. Should we see comparatively here or something else is there?

Rajendra Gogri: Yes. So, basically, we are trying to grow the Specialty Chemicals EBIT margins and eventually, we have reached to a high of 17.7% in one of the quarters last year. And long term, we have escalation to reach near 20%. Let us see when we can reach. I hope, next year, we will reach there.

Moderator: Thank you. The next question is from the line of Dipesh Mehta from SBICAP Securities. Please go ahead.

Dipesh Mehta: I missed some of your comment, the earlier part of the call. So, firstly about the slowdown which you are referring. It is largely restricted to domestic market? Or you are saying even in export market some kind of slowdown for products? And in that, what kind of end-user industries where we are seeing more pronounced slowdown? If you can help us understand that. Second question is about, last year, because of China disruption, we have some benefit in our operating profit side. Is it continuing even in Q1 or now things are normalizing? If you can help us understand. Thank you.

Rajendra Gogri: Yes, the major impact is more on the export side as far as the slowdown is concerned basically for agrochemical intermediate. It will be both, the end use market is export, but our sales wise impact is both, on domestic as well as exports. The finished molecules are more going towards the U.S. as far as agrochemicals are concerned.

Dipesh Mehta: Okay. And it is restricted to agro only? Out of, let us say, 5 segments generally which we refer to?

Rajendra Gogri: And automobile segment also. So, automobile segment, there is more impact on export. There are two segments, which are impacted, one is automobile and second is agrochemical towards U.S. So, agrochemicals, the impact for us will be both for domestic customer, who will be ultimately selling to U.S., their finished products and some of the export customers who will be selling to U.S. And for automobile sector, it will be majorly for exports, where the customers are making end products which are used in automobiles.

Dipesh Mehta: And sir, this slowdown, which we are referring to is something which, let us say, any kind of sudden reaction you have seen from clients? Or it is gradual and which we are witnessing even before Q1?

Rajendra Gogri: No, basically, the event has happened in Q1 only. You see the overall automobile slowdown is continuing in China and in general, overall. And agrochemical impact, basically, visibility everything has come in Q1 only.

Dipesh Mehta: Typically when, let us say, right now, we are seeing some slowdown. When it would be reflected in our numbers? Because Q1 number even at least from margin perspective, it is still showing some reasonably decent number? Do you expect it to have more revenue impact? Or would have more even margins side impact for us?

Rajendra Gogri: Sir, basically, the volumes will be impacted. That impact will be coming more towards end of second quarter and third and fourth quarter because the existing orders, which were there, that get executed. The impact will be more on volume, and then some cases, the margins also might get impacted.

Dipesh Mehta: Okay. And so you are broadly indicating it is as of now, H2 seems to be relatively weaker than even Q1 kind of number?

Rajendra Gogri: Yes, it is a very evolving situation. That is why we are not giving any specific numbers. But overall, the range what we had given 12% to 20%, will be a lower band than that. That is where we are right now.

Dipesh Mehta: Understand. And second question was about China. Last year, we had some benefits. Now Q1 numbers include any kind of benefit continuing? Or now it is normalized kind of number?

Rajendra Gogri: Yes, about Rs. 10 cores in our PDA business, I think, is little bit more abnormal than what we would have anticipated. But for most of the other products, I think things have quite a bit normalized.

Dipesh Mehta: And this PDA disruption because of event happened in China, now going forward or even today now seeing some normalization or it is still continuing?

Rajendra Gogri: No, that benefit we will get in Q2 also. Q3, we do not have any visibility. But Q2, definitely, the benefit will come because that orders are there. Going forward, how long it will continue in Q3 or Q4 that clarity is still not there.

Dipesh Mehta: And sir, last question is about the capex plan, which we have announced. If you can help us give some status on it? Where we are in terms of that execution?

Rajendra Gogri: Yes, capex, first quarter was about Rs. 240 crore, which was spend. This year, overall, Rs. 1,000 crore to Rs. 1,200 crore is something which we feel will be the capex.

Dipesh Mehta: There we are not seeing any kind of slowdown kind of thing because of market, we are slowing down in spending and other?

Rajendra Gogri: No, these are all ongoing projects, which are mainly based on our long-term contracts. There is absolutely no change in that respect.

Dipesh Mehta: And slowdown, would there not any implication on our long-term take kind of implications?

Rajendra Gogri: No.

Moderator: Thank you. The next question is from the line of Vishnu Kumar from Spark Capital. Please go ahead.

Vishnu Kumar: If you could just tell us what percentage of your current revenue across key segments would be from spot and medium to long-term contracts?

Chetan Gandhi: Generally, more than 50%, I would say, which is either a formal contract or a long-term structured business. It will be more than 50%. It maybe 60% to 70% business is much more visible and structured only 25% to 30% where there can be some variation in the volumes.

Vishnu Kumar: Okay. 60% - 70% would be some kind of a formal arrangement and 30% would be more of a spot. So, is this number same for specialty and pharma? Or would be different?

Chetan Gandhi: Pharma also, virtually, the customer visibility is there. Within both the cases, I think, it will be similar as far the volume visibilities and the pricing structure.

Vishnu Kumar: Okay. Got it, sir. And in terms of the new longer-term contracts if you could just explain how is the raw material pass through and FX? Is it a pass through? Or how do we manage that?

Rajendra Gogri: No, the raw material will be all pass-through and FX basically that we will have to do the proper hedging for FX.

Vishnu Kumar: So, we will have to do the hedging for the FX. So, generally, is it more like per kilo, per tonne profitability or is it a percentage margin?

Rajendra Gogri: It will be always on volume basis.

Vishnu Kumar: Volume basis, right. Got it, sir. Just going back in history, there was agro slowdown back a couple of years ago. If there is an inventory buildup kind of a situation, like, how long have you seen the customer coming back? Like, is it like two quarters - three quarters? Or it is almost like year and year and half away they come back and take their off-take volumes? Like, if you were to go back and connect to those similar, let us say, what happened two years ago and what is happening now, do you see there could be a prolonged delay for the markets to revive or?

Rajendra Gogri: No, it will be two - three quarters, I think and that also it is not in all the geographies actually. Few years back, it was across the board I think they had a slowdown. Basically, all two major markets, North America and Latin America are two major markets. Few years back, there was a slowdown much spread over more geography.

Moderator: Thank you. The next question is from the line of Rishab Bothra from Sharekhan. Please go ahead.

Rishab Bothra: Sir, on the long-term contracts when will revenue start coming in? I missed out on that part. I think the first contract was on agro side about Rs. 4,000 crore and second one was specialty Rs. 10,000 crore. So, will they accrue in FY20? Or both of them will accrue in FY21?

Rajendra Gogri: FY20 we will be just commissioning the plants. All the major revenue will come in FY21.

Rishab Bothra: Sir, both the plants will get commissioned in FY20 or in FY21?

Rajendra Gogri: Yes.

Rishab Bothra: Okay. And what will the debt scenario in terms of the capex we raised QIP? Is it sufficient or their will be debt borrowing as well for the capex?

Rajendra Gogri: This QIP proceeds are going to go in projects. But other part of that will be going to our internal accrual.

Rishab Bothra: So, there is no additional borrowing for the acpex?

Rajendra Gogri: Not for the contracts.

Rishab Bothra: Okay, fine. And what would be the tax rate for both the years?

Rajendra Gogri: Definitely on a five year tax holiday, 100% tax holiday. And after 5 years, 50% tax.

Rishab Bothra: Okay. So, we can assume that we will be under MAT for next two years - three years?

Rajendra Gogri: Yes, we should be in MAT.

Chetan Gandhi: Yes, we should be in the MAT for next couple of years.

Rajendra Gogri: And lastly, sir, if may I ask how has been the realization moving legs since you mentioned there are slowdown. So, has it cooled off for different products or how is it?

Chetan Gandhi: Yes, it will always be product specific because we are making so many different products going into different end-use. So, it will be always product specific.

Rishab Bothra: Okay. But for key products, which gives maximum revenue? Have we seen dip in realization?

Rajendra Gogri: No, basically, in few of the top 20 products, there is impact.

Moderator: Thank you. The next question is from the line of Kishan Gupta from CD Equisearch. Please go ahead.

Kishan Gupta: Sir, how much is the volume growth in specialty chemicals last quarter?

Chetan Gandhi: So, the last time, we have discussed that considering the kind of business profile what we have and the product mix and value addition, which is happening, volume growth is not a right parameter for us to look at the performances because it is a combination of product mix as well as the volume growth, which is going to drive the overall EBITDA growth. So, at constant raw material prices in this quarter and last quarter, we had a revenue growth of 9.4%. So, that essentially means that this 9.4% is resultant of the product mix and margin profile change.

Kishan Gupta: So, essentially, you are saying that you will not be able to say anything about the volumes as such.

Chetan Gandhi: No, it will not be possible to look at the volume growth because we would have product at a higher value-added chain coming in. They will not significantly add up to the volume growth but they add up significantly to the overall EBITDA. So, volume growth may not be a right way to look at it.

Kishan Gupta: And what is the impact of domestic slowdown in domestic consumption of late? So, what would be the effect on the specialty chemical business?

Rajendra Gogri: Domestic consumption, the impact right now is not any significant impact we are seeing.

Kishan Gupta: And you talked about the margins, EBIT margins for specialty last quarter was 22.5% and how much of that would be because of lower crude oil prices? The gains in margins from 17.5% to 22.5% year-on-year, so how much would be because of fall in crude oil places?

Rajendra Gogri: Generally, overall, the impact of this price reduction was about Rs. 34 crore. So, corresponding, as a percentage, I think, maybe about 1% will have to coming from reduction in the prices.

Kishan Gupta: Because of reduction in prices, you are saying 1% gain would be because of that in margins?

Rajendra Gogri: Yes.

Kishan Gupta: And basically, you talked about changes in the product mix. Could you elaborate a bit on what you are doing now and you were not doing a year back?

Rajendra Gogri: So, we have certain capacities which are fungible capacity. So, depending on the demand and the margin scenario, we move the product mix.

Chetan Gandhi: So, for instance, if you look at the earlier presentations, we used to have that chlorination and nitration process products, which is the category A and category B products, which are contributing more than 30%. In this quarter, the contribution for those products was close to 28%. So, it is more revenue coming in from a high value-added range of products.

Moderator: Thank you. The next question is from the line of Rohit Nagraj from Sunidhi Securities. Please go ahead.

Rohit Nagraj: Sir, you mentioned agrochemical forms about 25%, 30% and engineering polymers including auto, aerospace about 20%, which and all are the other major segments for our products?

Rajendra Gogri: Then there is dyes and pigment that is the third sector and fourth will be more of within specialty chemical, pharmaceutical then rubber chemical, oil, additives and all.

Rohit Nagraj: Okay. Dyes and pigments, how much would be the contribution for this?

Rajendra Gogri: That will be around 25% to 30% and 20% will be rest, pharmaceutical and others.

Moderator: Thank you. The next question is from the line of Dhruv Bhatia from BOI AXA Mutual Fund. Please go ahead.

Dhruv Bhatia: Just on China, have you seen any facilities being restarted? I mean, we hear and we read about it that the plant have restarted. So, have you seen that and has that led to any spreads compressing for you?

Rajendra Gogri: Actually, in China, continuously there are new plants, which are getting closed down and some of the older plants who might make the necessary changes, they are starting. So, it is a very cyclic situation in China currently.

Dhruv Bhatia: Okay. But have the spreads reduced? I mean, because there is a little slowdown also in demand, so have you seen I mean, if I categorize maybe in that A and B bucket, which you have talked about 28% of revenue. Have you seen the spreads compressing for you?

Rajendra Gogri: So, that will again depend on product-to-product how the situation has changed. For some of the product, yields might have gone down, some may have gone up.

Dhruv Bhatia: Okay, but directionally is it I mean, it is a mix of both. It is either some are up, some are down?

Rajendra Gogri: Yes.

Chetan Gandhi: Yes.

Dhruv Bhatia: Okay. And sir, just last thing, last quarter, if I am not mistaken, you had given a revenue guidance also 15-20% and 12-20% of PAT guidance. Now you are saying that the PAT guidance is you are revising it down with no number. It could be lower than 12% as well. But on the revenue guidance, I mean, is there a number that you can share?

Rajendra Gogri: That will be also lower, basically, revenue guidance also. There was a constant raw material prices we had given. So, that number will that band also will go on a lower side.

Dhruv Bhatia: I mean, will it be a single-digit number?

Rajendra Gogri: No, I do not think it will be reaching single digit but I think more clarity maybe after Q2 we will be able to give.

Dhruv Bhatia: Sure. And sir, lastly, just to understand when you have signed almost you said 60% - 70% of your contracts are long-term contracts? How many quarters of visibility does the customer give you, till last quarter, you had given a guidance of, I mean, a much better guidance in terms of revenue. But now you have seen some slowdown in auto as well as agri. I mean, how much of visibility do you have from the client in terms of demand?

Rajendra Gogri: Yes, generally two quarters - three quarters we will have going forward.

Moderator: Thank you very much. That was the last question. I would now like to hand the conference back to the management team for closing comments.

Rajendra Gogri: Yes, it has been a pleasure interacting with you over the call. 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 or would like to know more about the company, kindly reach our Investor Relations desk. Thank you.

Moderator: Thank you very much. On behalf of Aarti Industries Limited, that concludes this conference. Thank you for joining us, ladies and gentlemen, you may now disconnect your lines.

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