AARTI INDUSTRIES LIMITED

Aarti Industries Limited
Q1 FY21 Earnings Conference Call
August 13, 2020

Moderator: Ladies and gentlemen, good day, and welcome to the Aarti Industries Limited 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 call, please signal an operator by pressing * 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: Good afternoon, everyone. Thank you for joining us on the Aarti Industries Q1 FY21 Earnings Conference Call. We have with us today on this call Mr. Rajendra Gogri – Chairman and Managing Director of the Company, Mr. Rashesh Gogri – Vice Chairman and Managing Director and Mr. Chetan Gandhi – the CFO of the company.

Before we begin the call, I would like to point out that some statements made in today's call maybe 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 take you through 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. Firstly, I would like to wish you all to be in good health and to stay safe in the current, very difficult situation created by the COVID-19 pandemic. I trust that all of you would have received the Q1 FY21 financial results presentation that has been uploaded on the stock exchange website earlier today.

Q1 performance was largely in line with our expectations and the outlook shared with all of you during our previous interactions. As shared last time, during the quarter, on account of the lockdown linked restrictions, our units for the Speciality Chemicals segment were operating at about 50% capacity in the month of April. The same was subsequently ramped up progressively and thereby helping us to operate our units at 80% in the months of May and June 2020. We also faced challenges for sale of our products to the customers in domestic markets as some of our customers' units were also under lockdown during April and May. They started resuming activities on June 20 and hence this had impacted our sales in the domestic market.

Thus, this quarter had the maximum impact of the COVID-19 pandemic and gross income from operations for the company was lower by 9% at Rs. 1,035 crore. However exports remained almost stable at Rs. 487 crore. Within our business segments, revenues in Speciality Chemicals declined 11% while Pharma revenues moved up marginally.

Q1 EBITDA saw a decline of 27% due to higher operating expenses in respect of new facilities operationalized in Q4, including our fourth R&D center at Navi Mumbai. The same also resulted in the increase in the Depreciation cost for the company. On account of lower demand and logistics related challenges faced during the quarter, resulted into higher inventory at the end of Q1FY21.

Considering the value of Care, we had extended our support to the fight against COVID. In this regard, various measures were taken up to support the contract workers impacted due to the lockdown restrictions and COVID. Additional measures were done to support the NGOs leading the fight by providing necessary PPE and Medical equipment as per the need of the hour. We had also supported by making CSR contributions to PM CARES, State Relief Funds. The company had contributed over Rs 10 crs for these causes.

During the quarter, the Speciality Chemicals business was impacted by weakness in some key end-user applications such as automotive, aerospace, dye intermediates, pigments, etc that are dependent on discretionary spending. Demand from other segments such pharma, agrochemicals and FMCG, which contribute about 60% of our revenues, has remained firm.

I also want to highlight for the quarter we have recognized revenue of Rs. 38 crore being the shortfall fees eligible as per the terms of the long term contract.

Now for the Q1 production update, given the restrictions due to lockdown the production quantities in Q1 were lower as compared to last year. The production for Nitro Chlorobenzene was about 13000 metric tons for Q1 as compared to 16100 MT a year back. Similarly for the hydrogenated products we have achieved production of about 2050 MT, was about 1880 MT last year. On the Nitro Toluene front, the production for Q1 was about 2140 MT, which was about 2750 MT last year. At present, we are operating at around 90% of capacity across locations and expect a steady improvement in operating and financial performance through the next three quarters for the chemical segment.

During the quarter, our Pharma facilities continued to function efficiently. After some initial disruption, they have been able to deliver y-on-y growth and substantial expansion in margins driven by growing supplies of off-patent generics and other value-added products. Driven by higher operating leverages and product mix, segment profit expanded significantly from Rs. 32 crore to Rs, 45 crore, which is a new high for the segment while maintaining a flattish topline.

Going forward, capacity expansions will drive deeper penetration in therapies such as Antihypertensive, Cardiovascular, Oncology, Corticosteroids etc. We also have a strong pipeline of approvals and visibility to maintain growth momentum. The Pharma business continues to see profitable traction and growth will be accompanied by margins sustaining above 20% levels.

After the delays, as updated by us last time, in respect of various projects due to COVID-19 related challenges of Lockdown, Logistics issues and Labour migration, the project work has gathered momentum and the major projects are now track to completion as per the timelines last discussed by us. We like to share that the Chlorination project is at its final stage and is expected to be commissioned in the current quarter, while the other projects such as NCB expansion, expansion for Pharma USFDA Units, facilities for the long term contracts are scheduled to be coming onstream in next 18-21 months, in accordance with the plans given earlier.

In line with our previously stated guidance and as explained above we have witnessed the maximum impact of COVID-19 in our Q1 performance. This has resulted into our Consolidated EBIDTA to be lower at Rs 182 crs for Q1 FY21 as compared to Rs 219 crs for Q4 FY20 and 250 crs for Q1FY20. And the Consolidated PAT for Q1FY21 was at Rs 82 crs as compared to Rs 110 crs for Q4FY20 and Rs 138 crs for Q1FY20. As communicated earlier, we see the business delivering EBITDA growth in FY21, whereas profits are expected to be flat based on the higher cost of the expanded base of operations. We invested Rs. 222 crore in capital expenditure programs during the first quarter and are on track for our planned capex of about Rs 1,000-1,200 crore for FY21.

Going forward, our pipeline of new chemistries, processes and products remains robust backed by deep customer engagements and substantial investments in world-class manufacturing facilities. We remain strongly positioned to benefit as India gains traction as a preferred supply location for global corporations that look to establish stable and de-risked long-term strategic supply arrangements. Overall, we see the business bouncing back from this near-term disruption faced due to COVID-19 and will be able to maintain long term profit growth guidance of 15-20% over the next 3-4 years.

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 Kishan Gupta from CD Equisearch. Please go ahead.

Kishan Gupta: What is the integration between the Pharmaceutical and the Specialty Chemical segments?

Rajendra Gogri: There is no integration. We do not supply into Pharma, except for limited basic raw materials like – sulphuric acid or DMS.

Kishan Gupta: No integration as such?

Rajendra Gogri: No.

Kishan Gupta: On the administrative side as well?

Rajendra Gogri: Their manufacturing sites are different. There is no overlapping manufacturing, in the same site. Pharma sites are completely different. So that way administration is separate.

Kishan Gupta: How much revenue would the new products contribute over the next few years?

Rashesh Gogri: In Pharma, we expect 20% topline growth for the next few years.

Kishan Gupta: What about Specialty Chemicals?

Rajendra Gogri: That should be Rs. 1,000 crore.

Kishan Gupta: This is over the next 3-5 years?

Rajendra Gogri: Over the next 2-3 years.

Kishan Gupta: Rs. 1,000 crore in the next 2-3 years in Specialty and 20% in Pharma. How much of that would be from new products?

Chetan Gandhi: We are combining both. It will be the expansion of the current portfolio as well as new products. It will be a mix of both. We can say 50%-50%, would be new products and expansion of current range of products. In Pharma, the gestation period for any product to go commercial is almost 3- 5 years. Though we produce this product in smaller quantities, it becomes an existing product which grows.

Kishan Gupta: What would be the planned CAPEX of Rs.1,000-1,200 crore. Would you be able to give us a bifurcation?

Rajendra Gogri: Yes, we announced various numbers earlier. The Nitro Chloro Benzene expansion that is being carried out is about Rs. 150 crore. The Pharma expansion which is also currently being carried out is about Rs. 150 crore. The third long-term contract is about Rs. 135 crore. These are the major expansions which are going on right now.

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

Surya Patra: What is the provision of Rs. 38 crore in Speciality Chemicals? Which line item has it been factored into?

Chetan Gandhi: This is in relation to the contract. For a quarter, they would have to buy a certain quantity; if not, then the differential is eligible as the shortfall fee, which has been added to 'Revenue from operations'.

Surya Patra: Is this a charge/shortfall fee or the revenue that is impacted?

Chetan Gandhi: It will be an income, i.e., eligible to be an income.

Surya Patra: This would have nothing to do with deal cancellation or the compensation from the deal cancellation?

Rajendra Gogri: Yes, that is expected in the next year. In this year, it is a shortfall fee.

Surya Patra: Is this relating to the first contract that has been canceled?

Rajendra Gogri: Yes.

Surya Patra: The Company had guided for ~$120 million as the total compensation that is to be received; out of that, $20 million this year and $20 million in the next year. What would be the $20 million implication at the EBITDA level; would Rs. 38 crore be factored in the topline and flow directly to the EBITDA?

Rajendra Gogri: Yes. Out of the expected \$20 million, in this financial year. The Company has provided for \$5 million in the first quarter.

Surya Patra: The R&D center was commissioned; would this create a dent to the overall margin scenario?

Rajendra Gogri: That will not be much and is not as significant.

Surya Patra: On APIs – is there any advantage in terms of supply opportunities as China may not be catering and people might consider replacing purchases from China? What are the other API players witnessing; is there a similar trend in the export market?

Rashesh Gogri: Yes. In the API intermediates market, the trend is as you rightly said that – generic players do not want to buy intermediates from China if they are able to get the same intermediates from India. In API space, the Company caters to more of the regulated markets and the customers cannot switch from these projects overnight as they are also long-term projects. Regardless of COVID-19, the Company would have achieved the numbers and operating efficiency. The local sales are relatively lesser in the API category, in Pharma; it has seen some improvement of late, but the base is lower.

Moderator: Thank you. The next question is from the line of Chetan Thacker from ASK Investment Managers. Please go ahead.

Chetan Thacker: What would be the NCB and PDA volume? Is there any currency benefit?

Chetan Gandhi: NCB's production was of ~13,000 tonnes, in this quarter. PDA was ~360 tonnes per month, for the quarter. On FOREX, it is not a significant number and has been mentioned as a part of the note in the financials.

Chetan Thacker: How do we look at Specialty Chemical's EBIT number – would it be bookings of \$5 million for 4 quarters this year, a similar number for 4 quarters in the next year and then the final compensation after?

Chetan Gandhi: Yes, broadly.

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

Arun Prasath: The revenue guidance provided was of ~Rs. 1,000 crore in Specialty Chemicals, which is equal to ~8% per annum growth on the current base. Would this be correct?

Rajendra Gogri: That will have to be checked up number wise.

Arun Prasath: Is the Rs. 1,000 crore for the next 2-3 years combined?

Rajendra Gogri: Yes, Rs. 1000 crore plus.

Arun Prasath: Would there be any non-linear expansion in the margins as compared to the topline?

Rajendra Gogri: The topline is generally because of pricing and the like; the Company has a raw material pass-through model. The topline will be Rs. 1,000 crore plus, going forward, there will be value-added products and the EBITDA margin to turnover will increase simultaneously. There will also be an increase in the EBITDA margin.

Arun Prasath: Would the EBITDA growth be more than 8%?

Chetan Gandhi: Yes. Could you repeat the question?

Arun Prasath: Would you be implying that the absolute EBITDA from the Specialty Chemicals' projects should be much higher than the revenue growth?

Rajendra Gogri: Yes, the EBITDA growth will be higher than the topline.

Arun Prasath: The chlorination capacity is about to be commissioned this quarter; given the current slowdown and lower volume uptake, how would you be filling this capacity? Would it be just a depreciation charge or would there be any incremental revenue from this project?

Rajendra Gogri: Yes, our current capacity are at full level with not much scope to expand. The new capacity will help meet some requirements. So, we'll be able to sell part of this volumes coming out of it.

Arun Prasath: From this capacity, would it be like a PDCB kind of a product or a value-added product?

Rajendra Gogri: Yes, it will be both, value-added also as well as initial step products.

Arun Prasath: This would be right from the first quarter?

Rajendra Gogri: Yes.

Arun Prasath: What stage is the NCB expansion at? Is it on track or are there delays; also, would it be to full utilization?

Rajendra Gogri: The first phase will be in the second half of this year, the second phase will be more towards the second half of next year.

Arun Prasath: How has the product mix changed looking at pre and post COVID in the Specialty Chemicals' segment – is it on track or is there a permanent change?

Rajendra Gogri: The demand for the Company's products which are in – textiles, construction, aerospace and auto is down this quarter and will be down this year. Next year, as the global economy starts recovering, in FY '22, we expect volume to be more than FY '21, especially on small economy gains. The product mix, on a percentage basis; it is more skewed now on Agro and Pharma this quarter.

Arun Prasath: The EBIT margin for the current quarter would be a fair estimate unless things improve?

Rajendra Gogri: No, the overall volumes will improve. This quarter was bad because of the lockdown and the customer behavior. Although, going forward, it is expected that the absolute volumes will start increasing in this sector as well.

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

Abhijit Akella: Has the Company received any cash against the Rs. 38 crore that is booked; or would it be on an accrual basis?

Chetan Gandhi: It is on an accrual basis.

Abhijit Akella: When would the cash be expected?

Rajendra Gogri: There is a provision for it to be at the end of the year.

Abhijit Akella: Would it mean that the cash will booked after 2 years and a lump sum payment?

Chetan Gandhi: No, this is part of an annual setup. The cash, concerning this account, would be received after the end of the year.

Abhijit Akella: So every year, they would settle the balance for the year?

Chetan Gandhi: Yes.

Abhijit Akella: On the expense items – there is an increase in 'unallocable cost' and employee cost on a sequential basi. Would this be because of the new R&D center or is it a one-time provision? In the segment reporting – the 'other unallocable expenses' have increased on a sequential basis; are there one-off items here?

Chetan Gandhi: On 'other unallocable expenditure' – out of the total amount of Rs. 10 crore plus, Rs. 7.5 crore relates to the amount spent for COVID i.e., CSR activities like contribution to – the PM CARES Fund, the State Relief Fund, NGOs and other such activities. On the 'employee cost' – the staff welfare cost has gone up due to a couple of factors. One is due to the new facilities like – commissioning of the first phase of the Dahej unit in Q4; thus, there was a 'manpower cost' involved. Also, the Company has been extending support to the contractors and other various entities who have been operating during the lockdown. Hence, there has been additional staff welfare cost related to that, as well as a standard level of increment there. That has been released in the normal manner.

Abhijit Akella: On the Pharma side – is the margin expansion, in any way because of an increase in prices or realizations of key products, e.g., caffeine? What are the key raw materials and have they registered some correction?

Rashesh Gogri: In Pharma – we had an advantage of the currency this quarter as the rupee depreciated over the last quarter. Also, overall, we were able to produce budgeted volumes as we could sustain the production even during the COVID period. As far as caffeine and the raw materials are concerned, yes, because in the last quarter, there were issues in China. We had orders for large quantities in the current quarter, which were catered to because the production was continued. The raw material prices are slightly falling since mid of last quarter. Correspondingly, the caffeine prices have also started to drop a little bit. The raw material and caffeine prices are going to move in tandem and there may not be a heavy impact on the margin.

Abhijit Akella: What is the key raw material used in this?

Rashesh Gogri: There are several raw materials that are used in the manufacturing of caffeine. It could be aceticacetic anhydride, cyanoacetic acid or sodium nitrite. There are more than 10 raw materials, which are used.

Abhijit Akella: On the topline outlook for Specialty Chemicals of Rs. 1,000 crore – would Rs. 500 crore be coming from the second long-term project and another Rs. 100 crore from the third long-term project? What are the projects through which the remainder is achieved, specifically over the next 2-3 years?

Rajendra Gogri: Yes, it will be across the value chain, i.e., Nitro Chloro Benzene and Chloro Benzene's expansion and Nitro Toluene and PDA's ramp up. It will be more than Rs. 1,000 crore. Other than the two contracts, there will be volume growth across various lines.

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

Ritesh Gupta: On the revenue guidance, is it Rs. 1,000 crore incremental revenues on Specialty Chemicals or overall?

Rajendra Gogri: It is for Specialty Chemicals and is more than Rs. 1,000 crore. As mentioned earlier, the topline is not a major aspect that is generally tracked. It is more about the volume and the operating and gross profit that the Company will generate. So, that is a bigger number which we track.

Ritesh Gupta: In that context, would you be able to provide the guidance for EBITDA since the revenue guidance does not reflect breakeven.

Rajendra Gogri: No, the EBITDA range is witnessing 12-18% growth rate at the Company level; this is what we are looking at.

Ritesh Gupta: On the CAPEX split – from CAPEX of about Rs. 1,000-1,200 crore, Nitro Chloro Benzene is Rs. 150 crore, Pharma is Rs. 150 crore and the third long-term contract is Rs. 130 crore; the remainder is ~Rs. 500 crore; where would this be invested?

Chetan Gandhi: There would be the normal/maintenance CAPEX, mirroring depreciation of ~Rs. 250 crore. Also, there are a lot of other projects and products where the expansion activities are being carried out; it will be combination of those as well.

Ritesh Gupta: What is your take on the recovery; is the Company seeing any green shoots as the economy reopens? There would be benefits starting to accrue from the previous year's CAPEX and from what has been done in the last 2-3 years – what would be the guidance now, as in the previous call the guidance on EPS and profit was for it to be flat?

Rajendra Gogri: We maintain the same guidance, the main reason being the global slowdown. As you are aware, U.S., Europe, India and others are experiencing a slowdown. Thus, the products which are going there, the sector and volumes are impacted. That is why whatever capacity growth there may be, against that there is the demand slowdown. Hence, there is a combined impact where it would be flattish instead of a growth.

Ritesh Gupta: No change in the FY21 guidance?

Rajendra Gogri: No.

Chetan Gandhi: What we are saying is that we will be recouping the gaps that we saw in Q1, in the subsequent quarters.

Moderator: Thank you. The next question is from the line of Naushad Chaudhary from Systematix. Please go ahead.

Naushad Chaudhary: You have shared the NCB and PDA volume; could you also share the Hydrogenation and Nitro Toluene production for this quarter?

Chetan Gandhi: The Nitro Toluene volume for the quarter is ~2,140 tonnes. Hydrogenation is 2,050 tonnes per month.

Naushad Chaudhary: As of March 2020, the Company had inventory of ~95 days – what is status of the inventory and has there been any improvement versus the last quarter?

Chetan Gandhi: The inventory days would have gone up because if you see the numbers, there is a higher inventory position. Some of it was impacted because of the restrictions or due to the movement at ports, not operating at full-fledged levels with logistics also affected. Gradually, a few of the facilities started to operate from June. We do not have the current closing data but yes, the inventory levels have gone up slighlty.

Naushad Chaudhary: Would it be fair to assume that it would be more than 100-110 days versus 95 days, earlier?

Chetan Gandhi: Yes.

Naushad Chaudhary: Could you share the revenue mix of Speciality Chemicals in terms of value-added products versus traditional products?

Chetan Gandhi: Sorry, for question on the inventory level, we would not have reached 100 days. Even in last quarter it was not beyond 90 days, it was less than 90 days. There is some correction in the numbers that needs to be done.

Naushad Chaudhary: Where is the inventory piling up, i.e., finished goods or raw materials?

Chetan Gandhi: It is more of the finished goods.

Naushad Chaudhary: Okay.

Chetan Gandhi: The higher inventory that you are referring to is probably for Q4, relating to some of the products, which was being imported from China for the Pharma side of the business. We used to maintain higher inventory cycles beyond 100 days as a normal practice to encompass the issues related to the pollution and other problems in China. That was on the Pharma side; at the Company level, it was still a smaller number.

Naushad Chaudhary: What was the percentage of the revenue share from the value-added products in Speciality Chemicals?

Chetan Gandhi: The value-added products would be close to ~74%.

Naushad Chaudhary: On the inventory loss – as mentioned last quarter, there was a steep fall in the Benzene prices and there was an expectation of some inventory loss in this quarter due to this. How much inventory loss was there this quarter?

Chetan Gandhi: We are yet to work out the full number but there always has been some inventory loss. There has also been an offset to some extent because in a few of the export commitments, the contract has a quarterly lag on the pricing count. So, the earlier quarter's pricing prevailed in Q1 as well. It would have erased or helped us map some of the loss which would be there. We would have to look at the numbers and come back to you with that subsequently.

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

Dipesh Mehta: About the $20 million that the Company is likely to receive in the form of shortfall fees – what is its implication on the EBITDA margin for the segment? Ideally, the operating margin for that segment should benefit from it. If this is true, the margins should have been much higher than what was reported earlier since there are no expenses related to that revenue, which generally flows through. There should actually be a significant benefit because of the way the business is accounted.

Chetan Gandhi: There would be still certain costs related to the people, the overhead to the facility and other such costs. There would be some benefit but there is a significant cost also.

Rajendra Gogri: Depreciation of the first phase will also factor in.

Dipesh Mehta: Looking at Specialty Chemicals – it used to operate at 20% plus margin in normal times. Now, with this benefit, can there be a similar improvement in its margin? Q1 was a one-off because of COVID-19 related implications. Looking at the next three quarters, would that performance be at 20% plus this benefit?

Rajendra Gogri: Yes, that is what we are saying. Going forward, i.e., Q2 onwards, the plants would be operating at higher capacities. The demand and overall volumes are also better than what they were in Q1. In Q1 there was a substantial lockdown in some of the customers' facilities in India and the local sales were down. Hence, there will be a higher production and sales going forward i.e., in Q2 and the second half also.

Dipesh Mehta: Let's say that earlier, the Company used to operate at 20% plus; with this $20 million benefit, would we reach ~25% volume?

Rajendra Gogri: As a percentage it will again boil down to the raw material price and the like. However, at the EBIT level, the absolute number will grow.

Dipesh Mehta: That flow will be reflected from Q2 onwards?

Rajendra Gogri: Yes, it would reflect.

Dipesh Mehta: About end user industries – roughly 40% of the industries witnessed weakness in demand and 60% are fairly stable. How would they be in August; would the 40% of the industries witness recovery?

Rajendra Gogri: It is going to remain weak as it is not going to improve in one quarter. The entire year will be weaker, but progressively, the weakness is expected to become lesser.

Q4 may not be reach to the full extent; it is only in the next year that all the discretionary sectors will witness demand at the original levels.

Dipesh Mehta: About the Government announcement on a few products and link incentive schemes – does the Company have any plan to play on it, with the introduction of a new product or CAPEX?

Rashesh Gogri: We are studying the list. In the Pharma segment, we are operating generally in the newer products. The products mentioned in the PLI are more of the older products, in terms of the innovation. Though there are some matches, we are reviewing it and will take a call on it.

Moderator: Thank you. The next question is from the line of Nitin Agarwal from IDFC Securities. Please go ahead.

Nitin Agarwal: With the lockdowns and travel restrictions, has there been any meaningful impact on the business development activities; does it have any implications on the growth over the next few quarters?

Rajendra Gogri: No. This is making it more efficient, i.e., working from home. We have been able to connect to the overseas customers also on a conference call and such. Everybody is used to working from home and working remotely. As far as the business development work with the customers is concerned, we do not see any significant impact at all.

Nitin Agarwal: Over the last 3-4 months, there has been an incremental focus on companies de-risking out of China with alternate supplying sources. What are the changes that you are witnessing in the inquiries on business development?

Rajendra Gogri: Yes, this is happening across the board and has been seen in the past as well. We are at an advantage because we do not import anything from China; we begin from Benzene and the like. The buzzword now is having the supply chain independent of China. If they want to buy anything from India, the Indian players should not buy intermediates from China. We are getting inquiries for where the product value might be even \$30, \$40, \$50 or \$60. This traction is there and a lot of those products are under development and will come into production in coming years. There is a plan to set up a multipurpose block, where, in the future we can commercialize those kinds of products faster.

Nitin Agarwal: When would the impact of some of these initiatives play out for the Company; would it be in FY23?

Rajendra Gogri: Yes, it will be towards the starting of FY23, not in these 2 years. The actual financial impact on the production front will only happen in FY23.

Nitin Agarwal: On the CAPEX – in the next year, you will not have these large 2-3 blocks, which were outlined earlier; how should we look at CAPEX from FY22 and beyond and how is it now?

Rajendra Gogri: Yes, the Chloro Toluene range CAPEX will factor in. We have identified some Chloro intermediates which are more downstream as compared to our current range of products; so those Chloro intermediate blocks, Chloro Toluene and downstream products are in the design phase now. The construction of those plants will start in the next financial year – FY22, will start commercializing in FY23. Those are the broad and totally new range of products that will factor in.

Nitin Agarwal: On Pharma – from our perspective, there have been a lot of possibilities on the API space in China. In the Company's business mix, how much are intermediates and APIs? Would the bulk of the growth be from newer filings or would it be in your scope for growth in the current portfolio itself?

Rashesh Gogri: The business is split between 3 segments in Pharma – API, Intermediaries and Xanthine based products where the caffeine and derivatives come into the play. It is more or less equal among all 3 segments. We are seeing growth in API and API intermediates. No one wants to drink Cola in the current situation of COVID and that is where there is a slight pushback on the demand.

Nitin Agarwal: Is the Company looking to significantly up its investments in these 2 categories based upon what we see in the market?

Rashesh Gogri: Yes, we have announced expansion of the API facility, which is USFDA-approved, by acquiring adjacent land. We will be doubling the capacity in our API facility. In intermediates, one block will get started in this current quarter. We are also looking at the possibly a new site, where we could expand the intermediates in the next couple of years.

Moderator: Thank you. The next question is from the line of Rohan Gupta from Edelweiss. Please go ahead.

Rohan Gupta: On the guidance at EBITDA level over next 2-3 years – at the end of FY20, there was a significant CWIP of almost Rs. 1,400 crore, which is yet to get converted into gross block and start producing revenues from that. Also, looking at Rs. 1,000 crore further CAPEX in the current year, though out of the Rs. 400-500 crore can be maintenance and another small CAPEX, but Rs. 500 crore is still a larger CAPEX leading to the revenue. So, almost close to Rs. 2,000 crore in CAPEX, which would be spent; in an 18-month gestation period, i.e., FY22, it should convert to revenue. With the Rs. 2,000 crore investment, with the earlier track record of close to 1.5x as a turnover, are we missing something? Close to Rs. 3,000 crore of incremental revenue should flow into Specialty Chemicals by FY23, even though there is raw material price volatility.

Rajendra Gogri: No. As mentioned earlier, now the more value-added products are going to factor in and definitely, the turnout will be more than Rs. 1,000 crore. That was upward of Rs. 1,000 crore is what we had mentioned. It will not be the asset to turn over ratio, but will be relatively lesser and EBITDA percentage will be higher.

Rohan Gupta: With value addition, I hope that the incremental CAPEX, done last year and doing this current year, is not ROC dilutive? Ultimately, at the EBITDA level or ROC level, the cash flows and profitability should justify this kind of CAPEX. We have been having almost 20% plus ROC in Specialty Chemicals. Would it be in line with the ROC done?

Rajendra Gogri: Yes, that is what will happen. You have to see that the entire world, in 2021, is a washout because of the pandemic. The 2021 loss will be recovered in 2021-2022 and then 2022-2023; by FY23, the ROC numbers have to recover. That is what is going to happen.

Rohan Gupta: On the contract that got terminated, the Rs. 38 crore will get directly added at EBIT level and in revenues because the incremental cost on it is insignificant. The Company is not producing this product because it had earlier got the price to produce, if the customer got that, right?

Rajendra Gogri: Yes.

Rohan Gupta: So we continue to not produce and they will continue to provide us almost $5 million every quarter.

Rajendra Gogri: Yes, that is how the contract is.

Rohan Gupta: The Company is to start looking for some other markets for this products; are we working on that or would we be waiting for 2 years till the contract is with the customer?

Rajendra Gogri: No, we never had a restriction like that. We are looking at other markets and are also evaluating whether to go further downstream in this. It is still on a drawing board and we have not crystallized our philosophy on that. We can always apply it with the other entities and manufacturers of the same active ingredient. These are the various options that we are looking at.

Rohan Gupta: On the Pharma business – in the current year, the CAPEX is roughly Rs. 150 crore, but you seem quite optimistic with the current scenario in both APIs and intermediates. Over the next 2-3 years, what kind of investment do you envisage that can be absorbed in the Pharma business both – in a new facility as well as a brownfield expansion?

Rashesh Gogri: In Pharma – we are looking at Rs. 100-150 crore; further investment in the next couple of years of Rs. 150 crore.

Rohan Gupta: Rs. 150 crore, every year for next 2 years?

Rashesh Gogri: No, we would be looking at Rs. 75-100 crore every year.

Moderator: Thank you. The next question is from the line of Pratik Rangnekar from Crédit Suisse. Please go ahead.

Pratik Rangnekar: On the contract that got terminated – Rs. 120-130 million was your initial assessment. Have you got any confirmation from the client for this or is it still an assessment?

Rajendra Gogri: Yes. It is more or less in that range as of now..

Pratik Rangnekar: Okay. Fair enough.

Pratik Rangnekar: On some of the newer CAPEX initiatives that are still on the drawing board – if you could maybe quantify the opportunity expected or would it be like an import substitution theme? Is there an opportunity related number that you can put to the Chloro Toluene and the Fluoro intermediates mentioned?

Rajendra Gogri: just like we have Nitro Chloro Benzene and Chloro Benzene and Nitro Toluene, this entire chain will get ramped up in next 3-5 years. Some other various specialty intermediates and also customer-related products will factor into that; it is an import substitute. Second thing, it is a diversification. A lot of European and American companies want to diversify their source to India from China and certain products are growing globally. Generally, we see 3 factors – either that it has to be an import substitute, has to be global growth or where the customer wants to de-risk. That is the primary criteria for selecting any product line.

Pratik Rangnekar: What are the related products that you mentioned?

Rajendra Gogri: Either that it has to be growing globally, where in those products, the demand for downstream products has to grow or that it has to be an import substitute or where the customer wants to de-risk. Demand may not be growing, but they want to de-risk their supply chain. These 3 factors are the major factors for selecting the products. We will not select somebody else who is making it in India and tend to capture their market share.

Pratik Rangnekar: In the Pharma segment – are we independent from China or is there some dependence on China?

Rashesh Gogri: Yes. In Pharma, we have the steroid range of products where our dependency is there on China because steroids are manufactured only in China and U.S. largely. Apart from these products, there are certain intermediates that we buy, but will also have our own intermediate manufacturing block, which supports our API manufacturing. The advanced intermediates of most of our products are manufactured by us only.

Pratik Rangnekar: Would you like to put a number to that? How much would be China's dependence in the Pharma segment specifically?

Rashesh Gogri: We will have to work out that number. If you see the global chemical industry, anything which is not made in India, comes from China. A lot of small intermediates would come from China.

Moderator: Thank you. The next question is from the line of Siddarth Mohta from Principal PNB Asset Management. Please go ahead.

Siddarth Mohta: Out of Rs. 38 crore, which is part of revenue, how much will flow at the PBT level?

Rajendra Gogri: It's 90% plus.

Siddarth Mohta That would be around 35%. Thank you and best wishes for coming quarter.

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

Rohit Nagraj: On the terminated long-term contract – the facility is ready, is it being used for any other purposes? If not, then what will be the maintenance cost to keep the facility in workable condition on a yearly basis?

Rajendra Gogri: We already started utilizing that facility and exporting.

Rohit Nagraj: I suppose this was a Dichlorobenzene plant and there is another CAPEX on the Chlorination project, which is currently ongoing; are these 2 different products?

Rajendra Gogri: No, it is the entire value chain – Chlorination plant value addition. Totally different chemicals, but sequential.

Rohit Nagraj: On this year's guidance – 40% of our Specialty Chemical business is going through a rough patch, which accounts for almost Rs. 400 crore of quarterly run rate with an expected gradual recovery. How are we confident that we will be able to maintain the profitability at FY20 levels? Is it because of firm orders to be executed on which there is a take-or-pay agreement or anything else?

Rajendra Gogri: Yes, it is because the demand is down that we are maintaining the similar guidelines. The $20 million is not a totally additional amount coming from the product line of Agrochemicals. That is a new additional profit this year, coming in that line. The volume loss will be seen in the other factors.

Rohit Nagraj: The Rs. 1,000 crore incremental revenue guidance for Specialty Chemicals is for FY22?

Rajendra Gogri: More from the perspective of 2-3 years.

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

Nav Bhardwaj: It's revenue received, alright. Sir, in terms of the last CWIP that we had mentioned, that was at somewhere around 1,400-odd crore. Do we expect to capitalize the entire amount this year?

Chetan Gandhi: We would have a substantial capitalization of that in this year.

Nav Bhardwaj: And so the second utilization in the next year should be seen from the same, right?

Chetan Gandhi: Yes. So typically, we have like 3 to 4 years of ramp up pay. So we should start seeing the utilization happening.

Nav Bhardwaj: And sir, in the Spec Chem revenue that we got this quarter of roughly 840-odd crore, how much of it would be in non-agro, non-pharma entailed in that revenue basket?

Chetan Gandhi: So I guess non-agro, non-pharma would be in the range of around 30%-35% kind of stuff.

Moderator: Thank you. The next question is from the line of Vivek Kumar from Safe Investment. Please go ahead.

Vivek Kumar: This question is with respect to the demerged entity of Aarti Surfactants. So what is the current capacity in MP and the expansion plans for the next 3 years of the CAPEX amount, which we need?

Rajendra Gogri: No. This is a question regarding what?

Vivek Kumar: Aarti Surfactants.

Rajendra Gogri: So that is running as a separate company. So we'll not have any idea on that.

Vivek Kumar: Okay. Any vision, like we can give, like it was emerged from this company.

Rajendra Gogri: So yes. It's a separate Board of Directors. So the listing got delayed because of the regulatory issue, but the company is almost independently for almost a year now.

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

Sagar Jetwani: Sir, how many commercial APIs do we have now? And how many are in development stage?

Rashesh Gogri: Currently, we are producing more than 40 APIs. And we have an R&D program where we are going to have 5 products, which will get commercialized in this year and another 10 are under development.

Moderator: Thank you. The next question is from the line of Resham Jain from DSP Blackrock Mutual Fund. Please go ahead.

Resham Jain: Sir, just one question on CAPEX, which I'm still not able to get that. So 1,000 crore to 1,200 crore of CAPEX. And if we just add up all the CAPEXes which you have mentioned, there is still almost 500 crore, which I'm not able to reconcile. So if you can help with the remaining part of the CAPEX, like you mentioned NCB 150, pharma 150, long-term 3-year contracts 135, and 250 crore of maintenance. So still almost 500 worth of CAPEX is into which all lines is what I wanted to understand.

Rajendra Gogri: Yes. So other parts also some of the parts, we are doing expansion and some new products are also being added. So what we have mentioned are the big bucket items. In addition to that, some existing product debottlenecking as well as some new products are being added.

Resham Jain: It's like mostly debottlenecking. Does it include modernization as well, where it's not going to lead us to incremental capacity, but it's like on the environmental side, on the modernization front?

Rajendra Gogri: No. That is a normal CAPEX. This is to be more on expansion or new products. We are adding some new products and dedicated plant for the newer product also.

Resham Jain: Understood. And this is across all the products you're saying?

Rajendra Gogri: Yes. Different products will get a different debottlenecking as the volumes reach certain level, and we try to see debottleneck income expansions.

Moderator: Thank you. The next question is from the line of Akshath Ashok Naik from Alexandrite Capital. Please go ahead.

Akshath Ashok Naik: I just wanted to know what's your 5-year target for revenue and profit after taxes?

Chetan Gandhi: Sir, revenue, we typically don't look at revenue from an overall basis because the revenues linked with various raw material prices. On the bottomline, we are targeting growth of around 15% to 20% on a year-on-year basis for 3 to 4 years. So probably, you can look at similar kind of a number.

Akshath Ashok Naik: Okay. And just another question. I've been seeing that the promoter holdings decreased. Is this in normal with the charity that you all were planning to do? Or would you all be looking at increasing your promoter holding in the future?

Rajendra Gogri: I think earlier also, we had mentioned for whatever charity we had announced, all that we have been doing. Other than that, not much.

Moderator: Thank you. The next question is from the line of Aditya Ketan from East India Securities. Please go ahead.

Aditya Ketan: So my question is on the canceled long-term contracts. So will we continue to use the facility for the client for a few years or the capacity would be used for other customers?

Rajendra Gogri: No, we will be using that for that product.

Aditya Ketan: So the clients would be using the facility for a few years, because that was...

Rajendra Gogri: No, the client will not be using. They are not going to consume.

Aditya Ketan: But we will say that the clients will be using the facility for 2 years because we were in the notice period kind of a thing. So the client would not be using the facility?

Rajendra Gogri: No, because they are not putting up the plants, but we can give it to the other customers.

Aditya Ketan: And sir, the second question, the compensation amount of $120 million to $130 million, has this been vetted by the clients?

Rajendra Gogri: Yes.

Aditya Ketan: So customer has given the confirmation means that this amount has been vetted?

Rajendra Gogri: Yes. The entire first press release was vetted by them.

Moderator: Ladies and gentlemen, that will be the last question for today. I now hand the conference over to the management for their closing comments. Thank you, and over to you.

Rajendra Gogri: 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 and would like to know more about the company, kindly reach our Investor Relations desk. Thank you.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of Aarti Industries Limited, that concludes today's call. Thank you all for joining us, and you may now disconnect your lines.