Aarti Industries Limited

Q2 FY22 Earnings Conference Call Transcript
November 01, 2021

Moderator: Ladies and gentlemen, good day and welcome to Aarti Industries Limited Q2 FY22 earnings conference call.

As a reminder, all the participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal the operator by pressing "*" then "0" on your touch-tone 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 Q2 FY22 earnings conference call. We have with us today on this call Mr. Rajendra Gogri – Chairman & Managing Director, Mr. Rashesh Gogri – Vice-Chairman & Managing Director, and Mr. Chetan Gandhi – CFO of the company.

Before we begin this call, I would like to point out that some statements made in today's call may be forward-looking in nature and a disclaimer to this effect 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 afternoon and a very warm welcome to all of you attending this call. I hope all of you and your families are in good health, as we start seeing things coming back to normal.

I trust that all of you would have received the Q2 FY22 results presentation that has been uploaded on the stock exchanges' websites earlier today.

First a review of our financial performance:

As you may have seen, the first half performance reflects the strong traction we had been witnessing and also puts us firmly on track to meet our growth guidance as shared earlier this year. Our revenues crossed Rs. 1,750 crore during the quarter, which was up by about 33% YoY and over 17% QoQ. During the quarter, we continued to witness the sharp increase in raw material prices, fuel prices and logistics costs, which also contributed to the increase in top-line for the quarter.

Q2 EBITDA of Rs. 310 crore was fairly similar to the EBIDTA during Q1 and higher by about 22% as compared to last year, led by increased utilization of capacities and value addition in the product mix. In the last quarter (i.e., Q1 FY22), we had witnessed the Rupee depreciate by ~Rs. 1.20 vs. the US dollar, resulting into a mark-to-market loss for the ECB causing a rise in the finance costs by over Rs. 13 crore. This was normalised in the current quarter and with the QIP proceeds fully being utilised, there was a reduction of debt which helped in reducing the finance costs for the quarter. Our profit after tax came in at Rs. 176 crore, up 25% over Q2 FY21 and about 7% more than PAT for Q1 FY22. With these performances, we recorded the profits of Rs. 341 crore for H1 FY22, which is about 65% of the profits for FY21.

Both the top-line and bottom-line in the reported quarter are our highest ever in history. Thus, we have successfully extended the growth momentum achieved over last four quarter and have progressed well from the impact of the pandemic, which affected us significantly in the first half of last fiscal.

Continued volume expansion along with pass on for the higher input & logistics costs in the speciality chemicals business has reflected in jump in top-line of about 36% on YoY basis and about 20% on QoQ basis for the segment. We have seen return of demand from established markets to almost pre-covid levels and in some cases, it has surpassed the pre-covid demand volumes – that are clearly driving improved EBIT. Segment EBIT of Rs. 242 crore for Q1 FY22 portrays a growth of about 4% on QoQ and about 29% on YoY basis. As you are aware, we have a pricing model wherein the variations on RM are passed on to the customer, thus the better way to look at our performance is the change in absolute EBIT. While we are witnessing a significant and continuing rise in the prices of various key commodities, the fuel price rise emerging from the coal crisis situation was unprecedented. We have taken significant efforts to ensure that the business remains insulated from this crisis and also looked to pass on a substantial part of these costs to the customers, while having to bear a part of it. We hope the situation to normalise in coming months. These had also resulted in the increase in working capital for the company. However, the well capitalised balance sheet has enabled us to manage the situation pretty well.

Now for the Q2 production update. Production for Nitrochlorobenzene was at 20,347 MT compared to 17,830 MT a year back. Similarly, for hydrogenated products we have achieved production of 2,712 MT compared to 3,038 MT last year. On the Nitro Toluene front, the production for Q2 was 3,772 MT, compared to 4,119 MT in the same quarter last year. We operated at over 80-85% capacity utilization across our established locations and expect to deliver steady performance improvements going forward as new facilities scale up volumes.

Our pharma business grew by 15% YoY to Rs. 278 crore during Q2, which was similar to the revenue of Rs. 276 crore for Q1 FY22. The business continues to maintain growth momentum based on higher utilization of facilities that are driving volumes. EBIT for the pharma segment for Q2FY22 was lower to Rs. 41 crore, on account of the impact on margins due to higher inventory of the final product, which could not be shipped out and also due to the start-up costs related to the new scaleup facility coming on streams. Further business visibility in Pharma is based on higher volume from regulated markets, value-added products and new introductions of intermediate products. As you would know, we are currently implementing additional capacities for API's that are expected to be operational in the second half of FY22. We expect volume expansion to be supported by robust margins in this segment based on a pipeline of approvals that strengthen our position in therapies such as anti-hypertensive, cardiovascular, oncology and corticosteroids.

Now, an update on capital expenditure. We have incurred CAPEX of Rs. 317 crore in Q2 FY22 and CAPEX of Rs. 620 crore in H1 FY22; against the annual planned CAPEX of about Rs. 1,200-1,500 crore. At present, we also have several other capital investment projects in the pipeline. These includes expansion of USFDA capacities at the API unit located at Tarapur and at the intermediates' unit at Vapi, set up of production units for the 2nd Long Term Contract at Dahej SEZ, for the 3rd Long Term Contract at Jhagadia and the NCB capacity expansion at Vapi, expansion cum asset upgradation for our Acid Unit at Vapi, amongst various other projects which are underway. As guided last time, we are also undertaking various new growth projects driven by R&D and innovation, which will add over 40+ products for Chemicals and 50+ products for Pharma segment, driving growth beyond FY25. These initiatives provide the blueprint of growth for the longer- term horizon till FY27.

The Company at its Board meeting held on August 19, 2021 had considered and approved a Scheme of Arrangement ("Scheme") whereby the Pharma Business and allied activities of Aarti Industries Limited ("Demerged Company") would be demerged into Aarti Pharmalabs Limited (Formerly known as Aarti Organics Limited), a wholly owned subsidiary Company of Aarti Industries Limited ("the Resulting Company'), as a going concern basis with effect from the Appointed Date i.e. July 1, 2021.

As per the Scheme, The Demerged Company would demerge its Pharma business and allied activities along with a part of Speciality Chemical Business, which is a backward integrated facility providing feeding material to the Pharma Business. The said part of Speciality Chemical segment being demerged accounts for less than 3% of the revenues of the Speciality Chemical Segment. The demerged undertaking relates to Pharma manufacturing units, allied activities, investment with cash balance and cash equivalents for future capital expenditure of demerged entity. The demerger will enhance the focus and enable to adopt relevant strategies necessary to promote growth and expansion. As per the Scheme the shareholders of Aarti Industries Limited, as at the applicable date, we will get the proportionate stake in the resulting Company Aarti Pharmalabs Limited. We expect the process for getting the necessary approvals for the same in 9-12 months as per the restructuring proposed in the Scheme, the Company has restated the Segment Financials by reclassifying the part of Speciality Chemical Business (which is being demerged) under the Pharmaceuticals Segment in this segment report and the corresponding figures related to the prior periods have also been rearranged in a similar manner.

Over last year we had witnessed various global events which added to the volatility in the business environment. We wish to add that the Company is watchful of these events and taking adequate measures to mitigate itself and also drive opportunities from the new emerging trends evolving out of these events. We believe to be long term beneficiary from the various events unfolding in China and will add significantly to the 'China Plus One' strategy and place India as a fast growing and sustainable global supplier of choice to our customers.

To conclude, I reiterate our vision to grow during this golden era of opportunities for the Indian Chemical and Pharmaceutical industry and also to enhance its share in the global markets. We remain committed to work on these opportunities and drive on the growth journey which we have guided you during the last conference call. In FY22, we remain enthused about the short-term and long-term prospects of the businesses. Based on this visibility, we re-iterate our growth guidance of 25-35% for FY22.

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

Moderator: Ladies and gentlemen, we will now begin with the question & answer session. We will wait for a moment while the question queue assembles. The first question is from the line of Ritesh Gupta from Kotak Institutional Equities.

Ritesh Gupta: Congratulations for the good set of numbers. On profitability in the 1st half, it is on a softer base of last year and the Company did quite well with 40% growth on EBITDA terms on the 1st half basis. Getting into the 2nd half, looking at the base, it is also getting a little stiff plus the raw material inflation and the fuel price inflation has gone unprecedented after Q2. As you get into Q3 & Q4, in terms of inflation, would you be able to pass it on fully as done in Q2? With the new capacities and the like, getting commissioned, would the cost impact be seen in the 2nd half or should it be expected on net EBITDA basis; also would these facilities be able to contribute quite well?

Rajendra Gogri: Yes, you are right. There has been a lot of volatility, especially in various raw materials as well as in fuel. We will see how it pans out in the 2nd half. Generally, we are able to pass on the raw material variable to our customers. Broadly, in the 1st half, we have got about 65% of the profit of the last year. Overall, we should be able to maintain the range of ~25-35% of annual growth rate for the year. Also, in the 2nd half, some of the new projects will kick in, it will increase the expenses but should also be able to contribute to EBITDA.

Ritesh Gupta: On Pharma – should we expect the pressure to continue in Q3 as well or do you think that the issues you saw in Q2 were more temporary in nature? I am asking this because some of the other pharma API companies, while they have not done well in Q2, they have a muted outlook for the 2nd half. Do you share the same view as your commentary suggests that what you saw in Q2 seemed to be a one-off; or should we expect some profitability challenges in the 2nd half as well?

Rashesh Gogri: Yes, in Pharma, Q2 profitability had an impact due to 2-3 reasons and of course raw material pass on in Pharma takes time which will definitely have an overhang in the next quarter. However, the new capacities are coming in – in this quarter and in the next quarter, i.e., in the 2nd half of this financial year. With that on a longer-term we will definitely have better performance because as the new capacities kick in, the new production will bring in more opportunity to get into value-added sales.

Moderator: The next question is from the line of Rohit Nagraj from Emkay Global. Please go ahead.

Rohit Nagraj: Congratulations on a good set of numbers. On agrochemical intermediates, where the contract has been cancelled – I understand that we have spent close to over ~Rs. 400 crore. What is the status of that facility and has the Company started utilising it? What would it be used for?

Rajendra Gogri: Yes, we have commissioned that plant. As mentioned in our earlier conference call, we should be starting up the volumes mainly in FY23 and by FY24, we should be able to realise 80-90% of the capacity utilisation in this plant for the same intermediates.

Rohit Nagraj: Would this be for another customer?

Rajendra Gogri: Yes, it will be for other customers.

Rohit Nagraj: On the other two long-term contracts – these have got delayed. Is it a deliberate delay suggested by the customer or is it because of COVID-related issues? When would these be commissioned now?

Rajendra Gogri: Mainly it was a COVID-related issue. For the second contract, we are targeting chemical charging in Q3 and maybe in Q1 FY23, would commission the third contract.

Moderator: The next question is from the line of Surya Patra from Phillip Capital. Please go ahead.

Surya Patra: On the rise in costs seen in October – how would you be passing on the cost, particularly in specialty chemicals?

Rajendra Gogri: We have a raw material pass-through model. For the domestic market, it is passed on in the same month. The exports tend to have a 2-3 months' lag.

Surya Patra: Even though a large part of the business is customised, would the Company be passing on everything because of the way the prices have gone up? For even crude, in the last month itself, went up by another 15%. Would the Company still be able to pass it on swiftly and without a time lag, the way it used to be?

Rajendra Gogri: As I mentioned, in the domestic prices any variation in the price of benzene or toluene is passed on because that is how the pricing is generally done. In terms of exports, there may be a 2-3 months' lag because this kind of variation in our kind of products is not possible for us to absorb. In general, we do not see issues on the raw materials' plus/minus passing on.

Surya Patra: On the price/volume growth in specialty chemicals, what is the price-led growth and what is the volume-led growth for this quarter? There is robust growth obviously in the domestic market since there are trade challenges on the export side. That is why the domestic growth looks really strong. It is not only for the Company, but for many of its peers also, that is the trend. Could you clarify on that scenario as well?

Chetan Gandhi: The volume growth is in high single digits of ~8% or something and the rest would be the price-driven growth.

Rajendra Gogri: In logistics, we are able to manage some impact on the export front on the volumes because container availability is an issue. So, there we tend to divert the material in domestic market.

Surya Patra: Would this growth in the domestic market be sustainable if there were challenges as container availability seems to be a greater concern, likely to sustain in the near future?

Rajendra Gogri: Domestic demand is robust. If there is an impact in exports, we should be able to divert the material and rearrange the capacities for the domestic market.

Surya Patra: It was mentioned that gross margin normalised. We have been seeing a strong gross margin scenario since sometime in the range of 47-48% i.e., beyond 45% levels and now, 42% is a normalised margin. Thus, is this the kind of range that one should look at going ahead?

Rajendra Gogri: Last year, in Q2 sales were in the non-regular markets. We had to divert because in certain markets, the demand was less and the Indian market for Q2 was driven on a non-regular market. So, that is now corrected. This year, the supply that we have to meet has been made to the regular markets. That is how it is more normalised.

As a percentage, if the raw material prices increase, then the gross margin and the EBITDA margin go down. That percentage is not a correct measure.

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

Rohan Gupta: On the raw material availability and challenges from China – I think that the Company is buying some of the intermediates and raw materials from China. How the availability issue is right now and how does the Company cope with it? There has been a significant price increase also, in terms of these materials coming in. You said that it would be passed on. From the customer's perspective, would they be able to take on all the price increases?

Rajendra Gogri: Actually, for our Specialty Chemicals business, we are not buying any raw material from China. So, that Chinese impact is not there on our Specialty Chemicals business.

Rashesh Gogri: For Pharma, we require raw materials from China as we operate largely on higher value-added products. There the availability is there and of course, the prices have increased in China due to higher prices of the base raw materials and commodities. The products which involve phosphorus and such kind of base metal commodities, there the prices have risen sharply, but the products are available and we are able to get these products at a price.

Rohan Gupta: Would the Company be able to pass it on as there is a significant pressure in Pharma business margins in the current quarter? Do you see any delays in passing it on to the end customers or is it that this may just be a quarterly phenomenon? Also, you have always guided for at least close to ~18-22% margins in that business, would you be able to achieve that in the 2nd half?

Rashesh Gogri: In Pharma, the pass on will take a little longer time. It cannot be a monthly pass on. Next month, I cannot pass it on like the way we do in the Chemicals' business. It will take at least one quarter for us to pass on the increase and the prices have been rising continuously. Last quarter, we saw the prices increase and in this quarter also they are increasing. We are taking steps to ensure that these increases are passed on. If we unable to pass on the increase, then we take higher quantity, so whichever way we improve our profitability.

Rohan Gupta: Could you give an update on the margins?

Rashesh Gogri: Percentage EBIT would be in the same range of 18-20%, because we will have more value-added products coming in in the next 2nd half of this year.

Rohan Gupta: In Pharma, in the 2nd half, the margins will be 18-20%?

Rashesh Gogri: Yes, it will come up there.

Rohan Gupta: Despite higher top-line growth which will be at least 20% driven by prices?

Rashesh Gogri: Yes, we will be able to get it.

Rohan Gupta: On the second contract from SABIC. Just an update on that – which stage is at right now and are there any delays; when is the product scheduled to be supplied?

Rajendra Gogri: We are targeting to commission that plant in Q3 this year. The supply of the materials should start by the end of Q3 or Q4.

Rohan Gupta: Would you be able to achieve the full annual revenue run rate for FY23 or would it be a slow ramp-up?

Rajendra Gogri: We should be able to achieve the ramp-up.

Rohan Gupta: Full ramp-up in FY23?

Rajendra Gogri: Yes.

Moderator: The next question is from the line of Aditya Khetan from Stewart & Mackertich. Please go ahead.

Aditya Khetan: On the Pharma business margins – they contracted seriously in this quarter. In the last quarter, you had said that the reason for this is the higher inventory cost which would not be shipped to the client; it is a similar reason given in this quarter also. How much of the high-cost inventory is currently on the books; could it be rationalized in the coming quarter as you had said that the margins could improve from this level to ~18%? Has that impact been taken or is there an impact in the coming quarter?

Rashesh Gogri: In both the quarters, we saw challenges in moving the products because of the issues related to shipping. Also, some production delays resulted into the production of final APIs in the last 15-10 days of the quarter which resulted in delay in exports, due to which those could not be monetised into profits and they remained in stock. That will change. We are taking steps to control the overall stock of the products that we manufacture and are going to change the product mix in a way that we do not end up with this kind of a situation again.

Aditya Khetan: This impact is majorly on the API, API intermediate or in the caffeine segment? If you could just give an idea in which segment?

Rashesh Gogri: It is in the API segment and the caffeine segment – largely API segment in this quarter and it was in the caffeine segment in previous quarter. Because of unavailability of the containers, we could not ship them out, i.e., the containers which were on the port, etc. The shipping movement is gradually improving as we go along; in October we saw the situation ease out a bit for the Europe and US routes. Going forward, there should likely not be any challenge in getting this material shipped out.

Aditya Khetan: On specialty chemicals – it is clear that the business model works on a cost-plus basis, i.e., any increase in the RM cost also increases the top line consequently. The commodity prices are at an exorbitant level, wherein benzene is currently around Rs. 90 a kg. If there is a case where the global commodity prices start to fall and they come to a normalized level, which could pose a risk for the Company in terms of the top line. Would you change the guidance for the top line if the raw material prices start to fall or would it remain the same, which could then be offset from the newer business volumes?

Rajendra Gogri: Generally, our top-line guidance is at the constant raw material prices. If there are raw material fluctuations i.e., either up or down, the top line gets impacted. If the raw material prices go down, it will impact the top line, however it should not impact the gross profit or EBITDA as such.

Aditya Khetan: The top-line guidance will not change?

Rajendra Gogri: Yes, our top line guidance will change.

Aditya Khetan: Okay, that will be changed then?

Chetan Gandhi: Aditya, just to add to this – generally, our guidance is more driven on the bottom-line and not on the top-line. The top line as you know, is pretty volatile and one does not have control in terms of how the raw material, crude or the other prices would behave.

Aditya Khetan: On the chloro-toluene segment, this was the business which you were targeting. Would there be a road map and what is the capacity?

Rajendra Gogri: We are fine-tuning all the capacities and will be starting construction in the next year i.e., FY23.

Aditya Khetan: What would be the PDA segment volumes?

Chetan Gandhi: The PDA volumes were close to around 458 tonnes.

Aditya Khetan: What was it last year?

Chetan Gandhi: 470 tonnes.

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

Arun Prasath: Looking at the performance in H1 FY22 as compared to H1 FY20 – when there was no disruption from COVID, the difference is at the top-line level. The Company did not book anything on account of cancellation of the first contract in H1 FY20 whereas there was some chunk of revenue in H1 FY22. On this perspective, the top-line has grown by 19% CAGR whereas gross margins have not kept pace with the top-line growth. It has in fact grown at 17% i.e., lower than the top-line growth. Similarly, EBITDA has grown by 10% only. Given that the cancellation of the first contract should flow through the gross margins and EBITDA, why are EBITDA and gross margins not keeping up with the top-line growth and can it reverse in the coming months and quarters?

Rajendra Gogri: As mentioned before, the top-line is not connected directly because volumes become more crucial in general. We cannot directly take it on a percentage basis.

Arun Prasath: I am not comparing the gross margin or EBITDA margin but the growth in the absolute revenue, gross margins and EBITDA.

Rajendra Gogri: Okay, you are talking about growth in comparison to FY20, right? That we will have to check up as that number is from two years ago. However, in general because the Company's new capacities are still at a ramp-up phase, the expenses are higher. So, that impact will come in FY22. As the capacity gets ramped up, it should improve the EBITDA.

Arun Prasath: When we talk about the expenses that are below the gross margin like – shipping costs and the like, if they reverse, would the absolute pricing also reverse or would you be able to price at current levels even if there is a reduction in the shipping costs and other expenses?

Rajendra Gogri: If the shipping freight comes down, the price will come down. The additional prices that the Company is seeing is due to the higher shipping costs directly related to the increase in shipping. If it corrects, then the sales price will also correct.

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

Vishnu Kumar: On the new projects that will start in the next 18 months – you mentioned the SABIC contract will start in Q3. If it is possible to mention the timeline, when would the rest of the project's plants likely start over the 18 months and the indicative CAPEX that the Company would book in the gross block?

Rajendra Gogri: The new products will start mainly in FY24 – towards the end of FY24 and mainly in FY24-25. That would be chloro-toluene and its downstream products and some new downstream products in the existing Nitrochlorobenzene and chlorobenzene. More value-added products will be coming in.

Vishnu Kumar: If the Company has a CWIP of Rs. 1,600 crore plus, you mentioned that for the current year, Rs. 1,200 crore will be spent and out of it, Rs. 600 crore has already been spent. If I take Rs. 1,600 crore of CWIP and another Rs. 600 crore for the rest of the 6 months, it is Rs. 2,200 crore. I want to understand that of this, how much will get commissioned in the next 6 or 18 months?

Rajendra Gogri: Yes, most of them will get commissioned. Those will be the two contracts, the Nitrochlorobenzene expansion will come in place and the acid division restoration that is being done. In Pharma also, the 4 API expansions at Tarapur will also kick in.

Vishnu Kumar: Any rough CAPEX number that we will take to the gross block?

Chetan Gandhi: I would request you to look at the investor presentation, it has a slide in terms of the ongoing CAPEX activities which are expected to be commercialized by FY23 and also the future ones. That should address a major part of your query.

Vishnu Kumar: When would the Pharma division be split and how much of the gross block or the CAPEX get bifurcated?

Chetan Gandhi: From the new initiatives, the CAPEX which is targeted at Pharma is in the range of ~Rs. 350-500 crore that would get bifurcated.

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

Pratik Rangnekar: You mentioned that part of the RM increase was probably getting absorbed. Is the understanding right that this absorption of the higher RM cost is mainly on the export side where your contracts take a little longer to reprice?

Rajendra Gogri: Yes, generally in exports, it takes about a quarterly lag.

Pratik Rangnekar: There is no spread contraction or anything as such? It is just essentially the time lag. and so, in 3 or 2 months' time, that should balance itself out?

Rajendra Gogri: Yes.

Pratik Rangnekar: On the disruptions in China, would some of your competitors also be facing similar issues which could maybe beneficial to the Company? If yes, how would that benefit come through; would it be in terms of volumes or spreads?

Rajendra Gogri: At some places, there are disruptions and some of our products' margins will improve. However, there could be some volume impact if the customer is unable to sustain higher margins. Overall, things are very volatile in the sense of how the situation will be; price-wise definitely some of the products' margins are improving but there can be a corresponding volume contraction for some products.

Pratik Rangnekar: So, overall it would remain in the range of 25-35% itself?

Rajendra Gogri: Broadly, that is what we are currently estimating.

Pratik Rangnekar: Are you seeing any benefit in the ongoing quarter post the end of Q2?

Rajendra Gogri: That is what I was saying, for Q3 and Q4, somewhere the margins are improving but we see that some of the end-use industries are not able to sustain those kind of price increases. So, some balancing will take place.

Moderator: The next question is from the line of Ritesh Gupta from Kotak. Please go ahead.

Ritesh Gupta: On the numbers, when you talk about 25-35% growth, are you talking about the EPS growth or the PAT growth because there is a 5-6% differential in the PAT and the EPS for the year.

Rajendra Gogri: PAT.

Ritesh Gupta: Just on the spectrum side as well, it was said that the Company has already reached about 80-90% utilization. I was perplexed because the gross block was kind of doubled in the last 3-odd years. In that context, the gross profits have not really reached that level of doubling yet. We kind of had muted years of 2020 and 2021. Is it that you still are running at the realizations which are lower than let us say what you probably saw in 2019-20 or has the Company already reached optimum realizations from those products?

Rajendra Gogri: The 80-90% was what was already commercialized earlier pertaining to the chlorobenzene plant that we have set up. On some of the newer commercialization, they are yet to reach the higher capacity utilization.

Moderator: The next question is from the line of Rohit Nagraj from Emkay Global. Please go ahead.

Rohit Nagraj: This quarter, the Company has recognized $ 7 million on the long-term contract and last quarter, it was $ 4.5 million. Is there a reason for this?

Chetan Gandhi: It is the volume which is there across different quarters, based on the volume commitment the accrual comes in. So, if I look at it, last year it was $ 10 million for the first half and is broadly ~ $11.5 million for this year's first half.

Rohit Nagraj: On the 25-35% PAT growth, would this be organic, excluding the final settlement amount?

Chetan Gandhi: Yes, it does not include the last termination amount.

Moderator: The next question is from the line of Tanuj Mehta, an individual investor. Please go ahead.

Tanuj Mehta: Do you see long-term contracts contributing to one-third of the revenues in the next 1 or 2 years? In total, how many long-term contracts are there?

Rajendra Gogri: The contracts of a longer tenure, i.e., 10 years or so, were put in public domain, but we have a lot of other contracts which have 4-year/5-year terms and some of the contracts get rolled over; a 3-year contract rolled over 4-5 times. In terms of percentages, the contracts in the public domain would be ~10-15% of the top line.

Tanuj Mehta: In other terms, it could be said that another part of the sizable revenue would be from these kind of contracts which would be auto renewed or basically on which there is a consistent business flow?

Rajendra Gogri: Yes.

Chetan Gandhi: This includes contracts which are of a tenure of less than 5 years which are regular in nature and so on.

Tanuj Mehta: By next year i.e., FY23, the Company would be done with most of its CAPEX. Post that, would the margins increase in an upward trajectory; how would they be from that year?

Rajendra Gogri: The volume growth will take place in the products where the expansion will be finished in FY22 and FY23. On the margins, as the capacities will get further ramped up in FY24-25, that benefit will come up, but by that time, there would be newer projects which will get commissioned for the new product lines.

Moderator: The next question is from the line of Pranav Tendulkar from Rare Enterprises. Please go ahead.

Pranav Tendulkar: Congratulations on the numbers. From 2016-17, the Company's gross block has almost tripled or is 2.8x but its revenue has just increased probably 1.8x. Is this anomaly because the Company is entering into a larger space where the asset turnover is lower or is there anything else? If we do the same thing for EBITDA for fixed assets, that is also similar that EBITDA has moved to, I think, 1.7x or 1.8x, and gross block has almost 2.8x. I am asking this for a period of 5 years.

Rajendra Gogri: Generally, for value-added products the asset turnover ratio is lower and EBITDA also, because some of the recently commercialized or capitalized projects are yet to achieve full volumes. In general, the capital costs have increased and also some of the CAPEX was more on sustainability related measures.

Pranav Tendulkar: Can we assume this trend going forward?

Rajendra Gogri: The current numbers should become more of a benchmark than the earlier numbers.

Pranav Tendulkar: Currently whatever is commissioned, what is the EBITDA capacity of those commissioned projects? I am not saying CWIP which is ~Rs. 1,600 crore, but whatever is commissioned, what is the EBITDA capacity for it as you keep stressing that the EBITDA margin is actually constant and the pricing is not in our hands which I understand completely and I agree with it.

Rajendra Gogri: We will not have the absolute number available off-hand.

Chetan Gandhi: To address this question, considering what is there and what are the ones which are coming on stream from now till FY24, we have given a growth guidance considering the fact that many of these projects might start seeing decent utilization by FY24. So, from that basis, considering FY21 as a base, we are expecting the EBITDA or the bottom-line growth to be almost 1.7-2x of FY21. That should give you an indication in terms of where this will contribute to.

Pranav Tendulkar: That includes the CWIP commissioning also, right? So the Rs. 1,600 crore that is currently in the September quarter and then there will be some more CAPEX; this future CAPEX is also included in the guidance, right?

Rajendra Gogri: Yes.

Moderator: The next question is from the line of Amar Mourya from AlfAccurate Advisors. Please go ahead.

Amar Mourya: Just continuing with the last question. In FY20 and FY21, how much of the CAPEX has been capitalized; is it ~Rs. 2,000 crore?

Chetan Gandhi: Yes.

Amar Mourya: Plus now it is Rs. 1,600 crore of CWIP, out of this let us say by FY23, how much would be the capitalized number?

Rajendra Gogri: Rs. 1,600 crore will get capitalized, yes.

Amar Mourya: The whole Rs. 1,600 crore will get capitalized, right?

Rajendra Gogri: Yes.

Amar Mourya: So, roundabout Rs. 3,600 crore kind of CAPEX and if I see from 2020 to 2021 currently roundabout in terms of 2020 to 2022 the revenue growth would be the additional revenue which would have added to around Rs. 1,600 crore. So, when you say 2x kind of asset turnover ratio, is it like we are talking about adding Rs. 6,000 or Rs. 6,500 crore kind of additional revenue from this combined CAPEX in the next 3 years or 4 years?

Chetan Gandhi: The asset turnover ratio would not be in the range of 2x.

Amar Mourya: What would it be then; 1.5x?

Chetan Gandhi: Yes, it will have to be in the range of ~1.5-1.7x because many of these initiatives are at the higher end of the business on a value-added basis. Over there, there is a bit of higher investment as compared to the turnover. That is why the delta margin component over there was a bit higher.

Amar Mourya: Basically you are saying that in terms of the revenue turnover, that may not percolate but if I see the fixed asset versus the EBITDA…

Chetan Gandhi: Yes, plus the additional aspect is that a part of this investment which is done or in terms of sustainability initiatives, upgradation and other things will not add up directly to the turnover.

Amar Mourya: How to look at this number since you are saying that historical numbers are not valid in this context and you have made a lot of investment into the building blocks for the future CAPEX or for the purpose of sustainability? If it is not valid in terms of the fixed asset-to-revenue turnover, then how will it add to the bottom-line in the context?

Rajendra Gogri: Overall, I think 1.7-2x by FY24 and that should reach to almost Rs. 8,500-9,000 crore, top-line.

Moderator: The next question is from the line of Surya Patra from Phillip Capital. Please go ahead.

Surya Patra: At this current juncture, there is a kind of an abnormal situation in terms of cost, trade challenges and the like. Also, there is a kind of a peak disruption situation from China. In a way, this situation was supposed to benefit the Company in terms of an incremental supply opportunity whereas in terms of trade issues and the like, that is likely to have some impact on its supply capability. Considering these two abnormal situations, would there likely be a delay in the execution of the Company's long-term contracts? The second project which is supposed to annually add Rs. 500-odd crore; would that optimal annual run rate be expected by FY24-25 only and not in the near term or in FY23? Similarly, the third project of Rs. 90-odd crore, would that not come in the FY23 and rather in FY24?

Globally, this disruption is at its peak with more supply opportunities that should be coming. Would you have built any pipeline or a visibility of new contract signings achieved on those lines or any kind of business visibility that you have already added for the business? Has the Company benefited in any way in terms of its future supply capability?

Rajendra Gogri: For both, the second and third contracts, there is enough demand visibility so, we do not see any issues. We should be able to ramp up both the contracts substantially in FY23 itself. Overall, the 'China Plus One' strategy is panning out and we are continuously exploring one-on-one kind of contractual businesses as well as in the chlorotoluene range – which would totally be a multi-customer, multi-angle sector kind of product. Both activities are currently being pursued and we will see the growth in both ways.

Surya Patra: When you talked about the FY22-24 kind of outlook provided for the first time, at that time, you mentioned that you also started working on the developmental project with innovators for large global customers. Any updates there; what is the progress there and the nature of the revenue stream?

Rajendra Gogri: In Pharma, we have started working with innovators, and in chemicals, we already have multi-relations with so many customers. We have been working with them on that and they are at various stages. Some of them are in the R&D design and all those constructions will be starting; some of them towards the end of this year and major projects will start construction in FY23.

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

Rohan Gupta: Generally, we have seen that in a rising price scenario, in an inflationary trend, the Company benefits in terms of the cost or inventory. Earlier as well, with the disruption in China and fire at the Chinese plant, at that time, the Company benefited for almost 2-3 quarters from inventory gains. In the current scenario, it is a similar condition, but I think that this time, it is in the opposite direction and you are seeing margin pressure. Is there anything that has changed?

Rajendra Gogri: Generally, inventory gain takes place but some of the export takes on a lag. That kind of offsets with each other.

Rohan Gupta: Are you alluding to saying that in Pharma and in Specialty Chemicals, there may be some margin pressure because we are slowly passing it on to the end customer?

Rajendra Gogri: In Chemicals, local will be in the same quarter, but export generally has a lag.

Rohan Gupta: Are you seeing solid demand in the domestic market and much better than that of the exports' market? Where can it be quickly passed on to the end customer? Given the nature of the business, the Company always carries some raw material inventory of at least 1-2 months. When the Company is able to pass it on to the end customer within a month and also carry some inventory, at least for the time being, the Company should be able to see some margin improvement and some inventory-led gain which is somehow missing in the current quarter or has not been mentioned in your commentary. In an inflationary environment, we have always seen that the Company benefits from inventory gains which is somehow is missing.

Rajendra Gogri: You are right. There will definitely be an inventory gain, but when some of the costs are not passed on, that kind of offsets the margin. In the same way, if the prices are on a declining trend, the same thing happens. Part of the inventory gain or loss gets offset because of the impact from the lag.

Rohan Gupta: Is it that the Company is slow in passing it on to the end customer compared to earlier situations?

Rajendra Gogri: No, it is the same. There is no change in that.

Rohan Gupta: Looking at our spreadsheet, in the current quarter itself, if the Company even maintains the bottom-line PAT at a roughly similar level of Rs. 175 crore and if that run rate is maintained, the Company would be looking at a PAT growth of roughly 32% YoY. Your guidance is 25-35%. Do you see that there is no PAT growth even in the second half? The run rate that the Company has is roughly Rs. 175 crore at the bottom-line. Would the Company continue with that because it has commissioned a lot of capacities in H1 or at least in the last 3-4 quarters while the CAPEX commissioning or capitalization of that CAPEX should lead to volume growth which is somehow missing. You even mentioned that in the current quarter, there is only roughly 8-9% volume growth while there have been capacities added much ahead of the timeline in the last 3-4 quarters. Why is it so that you are not looking at a new guidance if the Company is to continue with the current run rate.

Rajendra Gogri: It is because there are a lot of factors, one being the coal price. The energy price is something which becomes difficult to pass on. We are making an effort to pass on the coal price, but a part of that impact will come in Q3 and Q4. That is why the guidance has been kept in a broader range. Also, the ocean freight, availability of containers and such uncertainties are still there. That is another reason that we are maintaining this kind of a guidance.

Rohan Gupta: So, because of this uncertainty in margins you see that there may be some margin pressure which may restrict the Company's bottom-line growth despite top-line growth?

Rajendra Gogri: Yes.

Rohan Gupta: You mentioned that the CWIP right now is almost at the highest ever level of Rs. 1,600 crore in H1 on the balance sheet. Also, you are going to add another Rs. 1,200-1,300 crore; it would be close to Rs. 3,200 crore kind of capitalization that you are talking about because you said that over the next 2 years and by FY23, you are going to capitalize all of this CAPEX. So, over the next one and a half year, we are going to see another Rs. 3,000 crore, roughly, getting capitalized. That is a huge increase in the gross block. Do you see that there will be a time period when you may struggle with lower utilization, perhaps at the end of FY23; or where you may witness some margin or bottom-line pressure, or would the utilization level continue to pick up without an impact on profitability?

Rajendra Gogri: No, some of the FY23 projects would be for newer product lines. That will not get commissioned in FY23 but will get commissioned in FY24 and FY25. The current Rs. 1,600 crore of CWIP, will be capitalized.

Rohan Gupta: By FY23?

Rajendra Gogri: Yes, whatever is ongoing will get capitalized, but the ones which we will be starting in the next financial year, none of them will get capitalized in the next financial year.

Rohan Gupta: Correct; however, in the current product pipeline itself, is the Company planning to invest Rs. 1,000 crore.

Rajendra Gogri: No, a part of that is already invested. A part of that is already part of this CWIP.

Rohan Gupta: I thought that you mentioned last time that you will be investing more in the product pipeline and the current pipeline or the current product line another Rs. 1,000-1,500 crore.

Rajendra Gogri: That is already done in these 6 months.

Rohan Gupta: So, you are saying that in the current product pipeline, hardly Rs. 500-700 crore more have to be invested; the rest all will be in creating the new product pipeline?

Rajendra Gogri: Yes.

Moderator: Ladies and gentlemen, that was the last question. I now hand the conference over to the management for their closing comments.

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

Moderator: Ladies and gentlemen, on behalf of Aarti Industries, that concludes this conference call. We thank you for joining us and you may now disconnect your lines. Thank you.