Aarti Industries Limited

Q2 & H1 FY19 Earnings Conference Call Transcript
November 02, 2018

Moderator

Ladies and Gentlemen, Good Day and Welcome to the Aarti Industries Ltd Q2 & H1 FY19 Earnings Conference call. As a reminder, all participant lines will be in the listen only mode. Should you need assistance during the conference please signal an operator by pressing "*" then "0" on your touchtone phone. Please note this conference is being recorded. I now hand the conference over to Mr. Shiv Muttoo of CDR India. Thank you and over to you, Sir.

Shiv Muttoo

Thank you. Good evening everyone and thank you for joining us on Aarti Industries Q2 & H1 FY19 Earnings Conference Call. We have with us Mr. Rajendra Gogri - Chairman and Managing Director, Mr. Rashesh Gogri - Vice Chairman and Managing Director and Mr. Chetan Gandhi - CFO of the company.

We will begin this call with opening remarks from the management following which we will have the forum open for a question and answer session. Before we begin this call, I would like to point out that some of the statements made in today's call maybe forward looking in nature and a disclaimer to this effect has been included in the 'Results Presentation' shared with you earlier.

We will begin this call with opening remarks from Mr. Rajendra Gogri who will take you through the strategic imperatives and performance of the company during the review period. We will then have the forum open for interactive Q&A session.

Over to you, Mr. Gogri.

Rajendra Gogri

Good evening and very warm welcome to all of you. Aarti Industries presence across integrated product chains, our diversified customer base, best in class manufacturing capabilities, timely delivery, adherence to specification and cost plus pricing model are enabling us to deliver consistent performance and become a partner of choice with global chemical leaders. We are happy to report that we have delivered the strongest performance in our history, reporting 46% growth in Revenues to Rs. 1,300 crore, 51% growth in EBITDA and 57% increase in Profit after Tax. The performance was driven by strong volume growth, additional benefit from expanding contribution of higher value products and foreign currency movement. Geography de-risking has also contributed to gross margin expansion which is further reflected in improvement in EBITDA margin by 40 bps Y-o-Y to 18.2% in Q2

As part of its strategy to safeguard business against currency rates the company had entered into a forward contract to hedge its export contracts. EBITDA impacted by Rs. 22.59 crore in Q2 FY19 and Rs. 51.54 crore in H1 FY19 due to loss on such contracts. Company had further provided for revaluation loss on long term borrowing to the extent of Rs. 9.1 crore as at September 30th2018. This loss has been provided in the finance cost of the company.

Our absolute EBIT which is the key metric to track since our realizations earnings to our global crude oil prices grew 60% Y-o-Y in Q2 FY19 to Rs. 203 crore and 53% Y-o-Y in H1 FY19 to Rs. 357 crore. Despite the Forex M2M impact. PAT grew 57% to Rs. 123 crore in Q2 FY19 and 50% in H1 FY19 to Rs. 212 crore. Volumes in Specialty Chemical segment grew by 10% in Q2 FY19. This business contributes to about 80% of our overall revenues in Q2 FY19 and is seeing operating leverage from higher capacity utilization across the various units. A strong optimism around the growth in Speciality Chemical manufacturing in India as indicated by the continuing geographical shift in production to India for various products has increased the demand for our product in domestic market thereby creating a large opportunity in import substitution products for domestic end users. We clock production of about 17,000 metric tonnes of Nitrochlorobenzene during Q2 FY19 as against 16,900 metric tonnes for Q2 FY18. We have continued to execute our CAPEX as per plans and have invested about Rs. 332 crore during H1 FY19. We achieved about 50% of capacity utilization for our ethylation unit at Dahej. SEZ Nitrotoluene unit at Jhagadia at the end of Q2 FY19. We expect this capacity to reach 80% to 90% utilization by end of FY20.

Moving onto the Pharmaceutical segment, we continue to sustain our momentum in this segment on the back of expanding business volume across markets and operating leverage. Revenue grew by 40% Y-o-Y in Q2 FY19 to Rs. 192 crore and 41**%** Y-o-Y in H1 FY19 to Rs. 342 crore. EBIT expanded 53% Y-o-Y in Q2 FY19 to Rs. 29 crore and 67% Y-o-Y to Rs. 55 crore. Since major fixed costs are already built-in, incremental volume results in significant increase in segmental profits. We will continue our focus on off-patented generics to be supplied in regulated markets.

Coming to the Home and Personal Care segment, the segment margins were impacted due to increasing input cost and change in product mix. As communicated earlier with an eye on creating a value for all stakeholders, we have set the process of demerger of Home and Personal care business in motion which we expect to close by the end of the financial year. We believe that we are now at an inflection point, looking at realizing the opportunity that lie before us. We are further planning incremental growth investment in area that provide long term visibility and as a potential to deliver returns that significantly exceed our cost of capital.

This includes expansion in capacity in existing product lines such Nitrochlorobenzene derivatives, Chlorobenzene derivatives, Nitrotoluene derivatives and ethylated compounds, fuel additives and pharma capacities, etc. as well as new projects currently on the drawing board. We also are also evaluating various options for securing additional land parcel to augment our long-term requirement for future scale up. Considering these various opportunities our Board of Director has passed an enabling resolution for raising funds for issuance of security to the extent of Rs. 750 crore. We have onus to raise this fund through the equity route, through debt or combination of both using any permissible mode considered appropriate by the management and of course subject to the requisite statutory and regulatory approval. I would like to reiterate that the fund-raising plan approved by our board is an enabling resolution for procedural compliance at this stage. Any capital raising requirement will also be supported by our continuing strong internal accruals by way of which our balance sheet will remain comfortably positioned to address any suitable growth opportunities.

To close, I would like to say that we are happy with the progress we are making towards execution of our strategic objective of driving profitable growth and value creation. We have a well charted road map laid out and making further growth investment in areas that provide long term business visibility. Our integrated operations flexibility and cost leadership has enabled us to develop 'Partner of Choice' relationships and has set us up well for the coming years. We like to reiterate our guidance about 12% to 15% volume growth for the current year and closer to 30% PAT growth. On that note, I conclude my opening remarks. We would be happy to give you our perspective on any questions that you may have. I would request the operator on this call to open question and answer session. Thank you.

Moderator Thank you very much. We will now begin the question and answer session. We have the first question from the line of Vihang Subramanian from Ambit Capital.

Ritesh Ritesh here from Ambit. Sir, just one thing on the enabling resolution that you have had, I think it would be great if you could just give us a highlight in terms of what kind of CAPEX plans that you are looking for? Is there something incremental that you are looking for which may make you do this kind of capital rising? And what is the thought process in terms of if you have any at this point in time in terms of how much debt and how much equity probably you might be looking for? And could you just give us a sense on how much working capital increase you might see because of this crude price increase and Rupee depreciation as well? And then the second one that I had was that on the pharma side, could you just guide us on what is driven this kind of strong profitability this quarter and what kind of growth rates you are looking at in this segment and what kind of opportunities you are seeing in this segment? And what are the key reasons which have driven this kind of turnaround in the business?

Rajendra Gogri Yes, basically in general we are seeing a good visibility in all our business line increase in the demand in domestic market as well for exports. We are seeing lot of manufacturing capacity coming up in India. There some other products which we are exporting to China and the finished products used to come back into India. Those are being manufactured in India. So, looking at the growth potential in all the various derivatives Nitrochlorobenzene, Chlorobenzene, Nitrotoluene we are planning to expand this capacity over next 2 to 3 years. For that we have passed this enabling resolution to raise about Rs. 750 crore and if we go by equity route it will have to be done by March, we can do earliest in month of March.

Ritesh And when I ask you about the opportunities, I mean lot of this is already announced like, so for example Nitro Benzene expansion has been announced already and I think probably on basis of my back of the envelope calculations you will go to probably 1.3 debt to equity next year and still we will be able to manage this kind of expansion whatever is there already announced with this kind of expansion with your internal accruals itself. So, is there something incremental that management is looking for in terms of growth expansion or is there something else which is on the cards which can probably make this kind of money.

Rajendra Gogri Yes, Nitrotoluene and ethylated compound we will be reaching about 80%-90% capacity by end of FY20. So, we are on our drawing board for our next level of expansion for Nitrotoluene also. And Nitrochlorobenzene ,also will be progressively expanding gross capacity to almost of about additional 40% from current and we have also identified some value-added products in these various business centers. So that also will be added in next 2 to 3 years. In addition to that, Chlorotoluene is in line which we are also looking at. So, there are various opportunities we are looking in because of that we would like to raise some additional money, so that we are able to capitalize on these opportunities.

Ritesh And Chetan if you could just give us a number on what kind of working capital increase you see on a like-to-like to basis because of crude increase and Rupee depreciation that you have seen as of now. What is your sense, how much working capital increase we will have?

Chetan Gandhi The working capital increase, if you would look at the balance sheet it has not been a significant number so far this year because we had a GST collections which were pending and all those stuffs that money has come in. So, in this particular period their working capital increase has been managed through internal accruals. So, going ahead I believe we continue to operate at around 100 days of working capital. So, depending on how this currency and crude would prevail. So, working capital increase should be in proportionate to those numbers.

Ritesh And current working capital as on say, 30th of September would be pretty much reflecting the crude and INR prices on that day, right?

Chetan Gandhi Yes.

Ritesh Or you would have or some old inventories which will be there?

Chetan Gandhi No, it will be all recent inventories. There will not be any old inventories.

Ritesh And, just on the pharma bit if you could just explain a little bit more what is happening in that business? What kind of opportunities are coming your way?

Chetan Gandhi Yes, in pharma business currently, we continue to grow our topline at 25% to 30% and we anticipate by the end of this year we will grow our bottom-line EBIT by 40%-45%. Overall, we see good growth in xanthine-based derivatives as well as intermediates these 2 segments are doing well and we have already announced, we will be adding some capacities in intermediates as well as the API additional block also manufacturing we will be investing in next 1-1.5 years. So, overall we are seeing good demand on pharma side and Rupee devaluation has also helped us in overall growth.

Moderator Thank you. The next question is from the line of Surya Patra from Phillip Capital.

Surya Patra Congrats on a good set of numbers. Some clarity on the multi-year deal. So for the second, 20 year deals we are getting the advance money around $40 million, something like that for the project execution. So, whether you have started receiving money from them and how, I mean what manner that you would be treating that in the financials?

Chetan Gandhi We have received $3 million as of September end for again that particular contract.

Surya Patra And where are you current factoring whether it is a kind of a deferred revenue kind of thing or what manner you are treating that?

Chetan Gandhi It is an advance from the customer. It is not deferred revenue. So, it will be part of the working capital.

Surya Patra And now on the result front. Our export growth basically is muted compared to that of the domestic growth what we are seeing. The demand in the domestic market will be much stronger, so that is why less export, but is there any difference between the profit profiles of those products, if you export what would be the margin profile and if you sell domestically how different the margin profile will be from exports?

Rajendra Gogri Yes, specially export with China when we compete in China against Chinese players the margin definitely will be of about 10% to 15% different than as the same products are being sold in Indian market. So especially against the Chinese export and domestic Indian market around 15% or so will be different.

Surya Patra But except China, export margin profile would be similar to that of the domestic business?

Rajendra Gogri Then other than that it will not be a big difference. It can be plus minus 5% sometimes, the domestic may be more sometimes the export maybe more. But again, China the freight and the Chinese import duty and the Indian import duty and Chinese additional tax, so that makes a sizeable difference.

Surya Patra And for the quarter we have, revenue side we have said that okay the volume growth for the specialty chemical is around 10%. But otherwise the actual volume growth is like 50% Y-o-Y. So, how much is coming from the price rise and how much because of the currency benefits?

Rajendra Gogri Yes, the raw material prices have also increased as well as margins also have expanded. So, both the factors are in play as shifting of some of the export to domestic also we have added additional margins. Benzene price was increased by about 20% as compared to the last year was around 50% and this year around 60%, Y-o-Y.

Surya Patra But is it possible to share that sir? How much is the price led revenue growth this quarter?

Rajendra Gogri No, it is basically total growth is about 50%, right and then 10% is the volume growth balance 40% will be basically in the prices, part of that will be passing on of the raw material and the other part will be increase in margin. So, there is a balance of those two in that 40% over and above the volume.

Surya Patra And in your opening remark also you have mentioned that, the geographic de-risking has contributed to the gross margin. So, I could not understand what was that?

Rajendra Gogri That is a similar line of what the activity which was more happening in China. So, that is happening in India and so, in export also we are seeing more possibility non-China export and within India also we are seeing more possibility where it is consumed for domestic Indian market as well as for export. So, overall the manufacturing and the marketing demand some churning is taking place in favor of India.

Chetan Gandhi Geographical de-risking is done by the customers.

Surya Patra And just last one question. Is there any impact that we can see because of the kind of that trade related benefit which is likely to be withdrawn by US. On few set of the products what they have mentioned, so I think couple of our products are there in the list. So, any impact because of that you are witnessing?

Rajendra Gogri That is you are saying in the GSP list.

Surya Patra Yes.

Rajendra Gogri So, you are saying the Indian GSP list which is announced.

Surya Patra Exactly this, Yes.

Rajendra Gogri Yes, I do not think we have any of our products but now you are mentioning then we will have to recheck.

Surya Patra See, basically I think it is NCB, ONCB, PNCB these 3 products are there, so that is why?

Rajendra Gogri None of them are exported to US because there is no consumption of ONCB, PNCB in USA.

Moderator Thank you. The next question is from the line of Sneha Talreja from Edelweiss.

Sneha Talreja It was more pertaining to the pharma segment. We have seen although your revenues are up significantly but we have seen margins coming back, coming down on a quarter-on-quarter basis. Can you just specify the reasons for the same?

Chetan Gandhi Yes, basically we had the cost pass on which has increased due to the Forex it takes 3 month lag in pharma. So, we will have improved margins in the coming quarter. So, that is one of the reasons. Other reason was that we had to switch to bio fuel and gas fuel in some of the plants where we had done around of coal boiler and stuff like that. So, which impacted, so we had higher fuel cost and I think we undertook some maintenance also. So, all these 3 factors have resulted in some margin getting impacted on a percentage basis.

Sneha Talreja Sir, next question was in this speciality chemical segment. Can you just specify how much would be the contracts, I mean what is the duration of your major contracts would it be quarterly would it be monthly? And what is the passing on condition?

Rajendra Gogri No we have different contracts duration. We have 5-year, 1 year, quarterly. Generally, all these contracts the raw material pass through is done based on a quarterly basis. Whereas, non-contractual business raw material pass through happens on almost on a month-to-month basis in domestic market.

Sneha Talreja Sir, can we say that lot of contracts we would be seeing passing on happening in the next quarter because the raw material price have increased a lot and next quarter we may not benefit that much due to the currency depreciation like how we have benefitted in the current quarter?

Rajendra Gogri No, more benefit will, now currency will be there the higher level and we have booked mark-to-market loss. So actually the benefit of currency will come in now and as far as the raw material in Q1 and Q2 there is not a significant difference in the raw material prices. And now the crude is also softening, so I do not think there may not be a very big raw material price difference between even in Q2 and Q3.

Sneha Talreja So, margin should remain at the similar level you mean?

Rajendra Gogri Yes.

Rohan Sir, just a small clarification on your guidance, Rohan here. You still maintain 30% PAT growth guidance while your first half growth itself has been 50%. Any challenges you are witnessing in a second half or just only margin of safety you are keeping while giving your guidance?

Rajendra Gogri Yes and generally fourth quarter we will have an asset shut down also and like we have been increasing the guidance after first quarter we had increased to 25% plus now we are saying around 30%. So, will depend how the actual numbers pan out because some of the margins are relatively much higher than a normal margins.

Rohan In chemical segment or in pharma?

Rajendra Gogri In chemical segment for some of the products. So, similar level obviously will definitely cross higher than 30. So, some margin clarity is not there in some of the products. That is why we are not guiding on a higher percentage than 30 right now.

Rohan Some of the product which you are highlighting that we are enjoying higher margins mainly coming from currency depreciation or it is coming from China situation?

Rajendra Gogri So, there is some China situation is playing out in some of the products.

Moderator Thank you. The next question is from the line of Chirag Dagli from HDFC Asset Management.

Chirag Dagli How has EBITDA per tonne for some of our large product categories behaved over the last 4 quarters in the specialty chemicals space?

Rajendra Gogri Yes, some products there is a structural increase because of exchange rate and some volume's additional utilization. In general, there is a growth. So, part of that is that and some products we are seeing a little bit more than a normal growth which is linked to more of the China situation. So, in those products we will have to see how the things stabilize in future. But in general the EBIT what used to be in FY18, FY19 and future for most of the product will be at the higher level.

Chirag Dagli Because this type of dichotomy 10% of volume growth and 63% EBIT growth in the second quarter. This kind of dichotomy we have only witnessed in the last 2 quarters, earlier there used to be some sort of matching between the volume growth and EBIT growth. The dichotomy just for the last 2 quarters has been fairly sharp.

Rajendra Gogri Because another point which I already mentioned is our export to China has moved to domestic consumption. So, that also is a structural shift. So, that is also adding into higher margin in these last 2 quarters.

Chirag Dagli In the first half for this specialty chemical business, what percentage of our business would be on the spot versus contracted? And how would it have changed in the first half of let us say this year versus first half of last year?

Rajendra Gogri No, generally certain products are contractual, certain products are more on spot basis which are on say like on a landed parity basis with China. So, there is not much change in this structure whatever used to be on a contract basis we have continued it on that format.

Chirag Dagli And in your opening comments did you mention Rs 332 crore of investments done in the specialty business or was this overall capital expenditure in the first half?

Chetan Gandhi Company as a whole.

Chirag Dagli Of this sir, can you split out how much you spend for these 2 big projects?

Chetan Gandhi We will have to work on that number.

Chirag Dagli Not yet but you have not spent as much.

Chetan Gandhi So, for the second project we may not have spent major amount. The first one we will have to see the numbers.

Chirag Dagli Can you guide to CAPEX for FY19 and 20?

Rajendra Gogri Yes, FY19 and 20 original we had said around Rs 700 crore and looking at these opportunities and the additional fund raising what we have announced, FY20 we might incur higher CAPEX. So, FY20 we can move towards Rs 1,000 crore also which should drive the growth in FY22-23 in those years.

Chirag Dagli On the pharma business, so this time around you are guiding to a much higher EBIT part of this is currency. In this business you get to keep the currency benefit to yourself, right sir? Or do you have to pass it on?

Chetan Gandhi No, we get to keep the currency benefit. So, basically we have 45% export of pharma and rest is domestic. But out of the domestic also 50% is import pricing driven. So, which is also Dollar driven. So, basically close to 75% of 70%-75% of business which is Dollar driven where depending on 30% raw material which is coming in Dollar denominated currencies. So, balance is what we are able to keep as matching.

Chirag Dagli Can you quantify the kind of opportunity you have in import substitution for intermediates and pharmaceuticals. You may have identified products over the next couple of years what should we expect from this bucket?

Chetan Gandhi Yes, so basically these segments particularly import substitution segment is intermediate segment, on which we are focusing and where we have that business comprising of total 30%-35%, 30% of our business of pharma is intermediate business which is fairly quickly expanding and there we are going to introduce couple of new products also which have large potential. We have started certain 2 intermediates which are now stabilizing and we may be able to sign a long-term contract also in one of them with innovators. So, there are lot of things which are happening in this space and we are quite excited about the intermediate story in pharma.

Chirag Dagli In terms of capacities what would be our systemic capacity utilization, for the business as a whole?

Chetan Gandhi 80% to 90% depending on products and plants.

Chirag Dagli So, for executing some of these new products we may need to do more CAPEX?

Chetan Gandhi Yes, so that is why we have announced more CAPEX.

Chirag Dagli Is there a number in mind over the next say 3 years what kind of capital expenditure can this business consume?

Chetan Gandhi Rs 100 crore to 150 crore in pharma business.

Chirag Dagli Annually sir or in total over 3 years?

Chetan Gandhi Rs 200 crore total.

Chirag Dagli Rs 400 crore.

Chetan Gandhi Rs 200 crore in pharma.

Chirag Dagli Rs 200 total over 3 years, sir?

Chetan Gandhi Yes.

Moderator Thank you. The next question is from the line of Sarvanan Viswanathan from Unifi Capital.

Sarvanan Viswanathan So, given that we are on a business as a whole we are around 90% capacity utilization. Though the current margin represents sort of peak margins potential? Or it could be enhanced by price realizations?

Chetan Gandhi So, I think in pharma we have scope of some expansion. I think, if we do proper product mix and our intermediate new product launches will happen in next couple of quarters. So, there will be some margin expansion there and I think on specialty side also, I think we are at reasonable level now. So, we hope there is further increase.

Sarvanan Viswanathan And in terms of the fund raising you hope to, I mean did I hear you correctly? You hope to conclude by March.

Rajendra Gogri No, that is earlier if we want to go by equity route because we have done a buy back last year. So, earliest we can do is in the second half of March as far as any equity raising is concerned.

Sarvanan Viswanathan And for FY20 are you giving any indicative volume growth numbers?

Rajendra Gogri Yes, volume growth basically it is the 3 years from FY19-20-21. Overall, around (+15%) volume growth will be there.

Sarvanan Viswanathan 14%-15%?

Rajendra Gogri Yes, around +/-15% in the 3-year period, ;19-20 -21.

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

Nitin Agarwal On your business one component of growth as you mentioned has been increasing component of higher value products. Sir, how should we visualize or sort of look at this piece of revenue growth or profitability growth going forward? I mean, in terms of what could be the magnitude of this thing, I mean what proportion of incremental growth could really be coming from just moving up the value curve?

Rajendra Gogri That bifurcation we have not done but in general we have been expanding and adding capacity on downstream value-added also along with the upstream and when we sell value-added and we get contribution from the beginning. So that is as a percentage but bifurcation as such will be difficult to get.

Nitin Agarwal But not from exact number perspective but with the growth that you have done in, in the first half of the year, so this value-added part of it would be a large component of that growth?

Rajendra Gogri Yes, substantial view of that.

Nitin Agarwal And, this should be sticky, right? I mean, this kind and the growth that has coming through this route should stay irrespective of the raw material price movements and everything, currency in the raw material some of the other external variables which are there?

Rajendra Gogri No, there also there can be a Chinese impact, no? So, value-added products also are impacted by Chinese shortages.

Nitin Agarwal And what is the sense, are these some of these shortages temporary or these are more structural in nature?

Rajendra Gogri Some of them may come back. But overall we see that margins will be higher because chemicals have so many products. So, which one will come back when in next 1-2-3 years, how capacity rationalization takes place in China we will have to see on a product-to-product basis. But in general, as earlier said geographical de-risking the foreign customers also want to source more from India and also if the Indian capacity comes then there can be more of a long-term shift of demand taking place into India.

Nitin Agarwal With the crude now beginning to soften a bit, I mean, does it mean vis-à-vis trend which you are seeing on a crude for whatever movement it has had over the last couple of weeks. Does it really have a material impact on our revenue growth in the second half of the year, sir?

Rajendra Gogri On the volume growth crude we are crude agnostic.. So, it does not make much difference. Only on the topline absolute number only the crude price gives an impact.

Nitin Agarwal Sir, lastly on the Chlorobenzene business which we talked about increasing capacity by about 40%-odd. I mean how much scope do you see in this business incrementally I mean, you already are a large player in this segment how much more can we grow on this business?

Rajendra Gogri No, we are seeing a lot of other products which are actually some of the downstream which are imported into India. And so, we will be adding some more value-added products in that range also. So, one will be a normal growth in India and another will be some other downstream products which are imported into India that either internally or some other Indian companies are planning to put up those capacities. So, both normal growth as well as some import substitution and some of the products which we are planning which will be for exports. So, all those combination we see that we should be able to sustain this volume expansions.

Nitin Agarwal And, lastly you talked about your intent which is to majorly step up your CAPEX because of the opportunities that you see. Sir, in your assessment what is the major driver of this expansion of the opportunity that you see. Is it largely the China factor or something else which is sort of driving this expansion of opportunity space which is opening up for you?

Rajendra Gogri No, basically I think we have been told many times that it is only China and India are 2 players in this and they play out with each other. And the Indian base is much smaller. So, as a percentage of opportunities in India will be definitely substantial. And in China as the behavior become more irrational with the government shutting down total and all that. So, multinational would like to source more and more from India as far as possible. So, I think this will play out for next few years definitely and depending on which companies are able to develop the products and invest but the volume opportunities are surely there.

Moderator Thank you. The next question is from the line of Nav Bardhwaj from Anand Rathi.

Nav Bardhwaj Congratulations on fabulous numbers. Just a small bookkeeping question. Could you throw some light on the other expenses and its movement like 28% of movement Y-o-Y and about 17% Q-o-Q. Could you please explain a bit more about that?

Chetan Gandhi So the other expenses relate to the cost of manufacturing, certain increase in the freight cost linked with crude and volume linked cost which are there.

Nav Bardhwaj So no sustainable view can be formed on the other expenses going ahead like.

Chetan Gandhi What will happen is certain parts of other expenses would be variable and linked with volumes as such. And will also be linked with external factors such as crude and other things. There will be certain expenses, which will be largely fixed in nature. So, it will not be possible to comment on an absolute basis as to how the other expenses would move going ahead. We have other capacities coming in all those stuffs so there will be some further increase happening.

Moderator Thank you. The next question is from the line of Parth Adhiya from B&K Securities.

Parth Adhiya If you can just share the hydrogenation and PDA numbers for the quarter?

Chetan Gandhi Hydrogenation numbers we are close to around 2,100 tonnes per month and PDA was almost around 550 tonnes a month.

Parth Adhiya And Nitrotoluene?

Chetan Gandhi Nitrotoluene is close to around 45% of utilization.

Parth Adhiya And what about Nitrochlorobenzene? Those I think you mentioned around 19,000?

Chetan Gandhi 17,000. (+90%) utilization.

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

Kishan Gupta Given that your volume growth is 10%-15% which is not that great. Do you risk overcapacity in some of your products?

Rajendra Gogri Generally, we have a quite good visibility with all our customer interaction and in general we are able to reach to around 80%-90% between 2 to 5 years.

Kishan Gupta So, basically as you said that is a gradual ramp-up but since your volume growth it is just 10%-15% and you are ramping up your capacities. So, is there a mismatch there?

Rajendra Gogri No, like we say, NCB will be expanding about 40%-45% which kind of takes care of about 3 to 4 years growth levels. So generally we will be expanding which should be 3 to 5 years, we should be able to fill those volumes.

Kishan Gupta So, is it like it going to taper in the future year CAPEX after FY'20?

Rajendra Gogri No, we are looking at some other range also as we said, say it Chlorotoluene is one thing which is not made in India at all and so that is just like what we started in Nitrotoluene will be starting in that range of products and there are some other further downstream opportunities are also there in our existing business center also on Nitrochlorobenzene and chlorobenzenes. So, overall there are lot of good opportunities in manufacturing we feel and also some of the contracts which we did, which was on a long-term manufacturing contracts so that vertical is also possible because so many things are currently imported into India. There are huge imports also taking place and a lot of products which are virtually exported only from China in global markets.

Kishan Gupta And, what about margins like generally your margins are inversely related to crude. So, basically in the sense that your margin is on a fixed dollar basis. But here we see your margins expanding from 18.6% to 20.2% Y-o-Y. I can understand some bit of it because of currency impact also. How would you explain that?

Rajendra Gogri As we said earlier also, our markets are shifting from one geography to other geography and in general some of the products currently are running at the higher margin than a normal margin level.

Moderator Thank you. The next question is from the line of Jigar Shah from Negen Capital.

Jigar Shah Sir, my question is related to the home and personal care segment, could you give us a timeline for the demerger and the debt that would go into the home and personal care segment, post-demerger?

Chetan Gandhi So the debt will go to home and personal care segment would be around Rs. 55 crore?

Jigar Shah And what is the timeline for the demerger?

Chetan Gandhi We are targeting to be able to get the approvals from various authorities by March we will be seeing how it progresses.

Jigar Shah The utilization level this quarter and revenue guidance for FY19-FY20?

Chetan Gandhi So the revenue guidance for FY19 and 20 we are targeting 15% kind of volume growth. So, at constant prices, the revenue should be at similar level.

Rajendra Gogri As far percentage utilization, our different segment we already said this Nitrotoluene and ethylation we are more towards around 40% to 50%, Nitrochlorobenzene we are towards 90%. So, different business center we are at a different level of utilization and so different ramp up status.

Jigar Shah Would there be any CAPEX going ahead in this?

Rajendra Gogri Yes, what all the expansion and all we will be having CAPEX for that.

Jigar Shah And could you also tell me the loss for this quarter in this segment?

Rajendra Gogri I think there are some confusion. You are asking for home and personal care?

Jigar Shah Yes, home and personal care but you spoke about some …

Rajendra Gogri The loss I think was some of the raw materials also some pricing in the product mix related and some operational issues that has given a loss in this quarter.

Jigar Shah Could you quantify the loss?

Rajendra Gogri I think EBIT level it is …

Chetan Gandhi Around Rs.3.7 crore.

Rajendra Gogri Rs. (3.7) crore.

Moderator Thank you. The next question is from the line of Chetan Thakkar from Ask Investment.

Chetan Thakkar Sir, just wanted to check one thing. When you said total volume does that include NCB, PTA and Nitrotoluene?

Chetan Gandhi Yes, it's all chemical products and the products in the entire speciality chemical segment.

Chetan Thakkar So, these 3 would be the starting point and hence these 3 should be added and hydrogenation is a stage forward. So, that will be included somewhere near within the 3.

Rajendra Gogri And there is a chlorobenzene also. So there is a fourth segment which is of chlorobenzenes.

Chetan Thakkar So what is that absolute number of volume for Q2 and similar for Q2 last year like you have given 17,000 for NCB and …

Chetan Gandhi No, so that 17,000 is only for NCB. So, NCB for Q2 last year was at 16,900 fairly similar number.

Chetan Thakkar Sir mentioned that there is 10% volume growth. So, just wanted to know what is the absolute which is giving that 10% and similar base. Because this is just NCB volume.

Rajendra Gogri There are lot of downstream products, there are standalone products and another value chain is of chlorobenzene also. And entire Nitrotoluene was not there last year. So, that is Nitrotoluene and everything has come on our volume growth. Because last year it was commissioned only in the second half of the year.

Chetan Gandhi And, it is not a simple aggregation or simple average on the volume number. It is a weighted average numbers.

Chetan Thakkar And the Nitrotoluene is 30,000 tonnes capacity, am I correct?

Rajendra Gogri Yes.

Moderator Thank you. The next question is from the line of Abhijit Akella from IIFL.

Abhijit Akella In terms of the hedges outstanding we had some Rs. 1,000-odd crore at March, I believe we have done some cancellation, etc. So, what is that number stand at now?

Chetan Gandhi So, the numbers as of September was close to $85 million, so that should translate into almost Rs. 600-odd crore.

Abhijit Akella So, we have sort of reversed the hedging policies is it, we were earlier talking about taking increased hedges going all the way out 3 years. So, now we have sort of dialing back on that, is that correct?

Rajendra Gogri No basically, we are doing for 3 years but 2nd and 3rd year will be generally lower than the first year and generally will be looking at around $70 million to $80 million which we maintain over the next 3 years' period.

Abhijit Akella As the revenues grow the \$70-\$80 million would that also grow or you will keep it at that level only?

Rajendra Gogri Right now at least that is the policy, we may review after 6 months. Like every 6 months or so we will like to review policy of the hedging.

Abhijit Akella And this quarter's revenue growth of this 50% in specialty chemicals you mentioned 10% volume growth 20% raw material pass through. Is there an FX benefit also over and above that some contribution to grow some FX?

Rajendra Gogri Yes, part of the margin growths will come from FX also.

Abhijit Akella And one last thing this unallocated expenditure is up quiet sharply this quarter in the segment. So, it is about Rs. 32 crore compared to Rs. 22.7 crore last quarter.

Chetan Gandhi Yes, it is a net of other unallocated income. So, in last quarter there was a dividend income of around Rs 3 odd crore which has reduced its number from 26 to 22. And this quarter there will be some incremental expenses in terms of some admin cost and certain CSR activities and also certain R&D expenses which is not allocated.

Abhijit Akella So, about Rs. 28 crore to Rs. 30 crore per quarter is a good run rate to work with?

Chetan Gandhi Yes, it should be around that number.

Moderator Thank you. We will move to the next question. The next question is from the line of Chirag Dagli from HDFC Asset Management.

Chirag Dagli For the pharma segment in the import substitution bit, how we will be protect ourselves from our potential threat from China coming back?

Chetan Gandhi Basically whatever intermediates that we are manufacturing we are also looking at doing forward integration if possible and make that API ourselves so that we become vertically-integrated in that product. So, for example, we are looking at producing Montelukast intermediate and also producing Montelukast. Or we are looking at producing Moxifloxacin intermediate as well as in future within the group we may produce Moxifloxacin. So, these kind of strategies we are doing but we cannot do everything. However, we are also looking at more new generics where of course China is there and we are also there, so what is the change that is happening is that instead of having only Chinese manufacturers approved vendor for the filings, Indian companies are more open to have one Indian source. So, that is a space where we will not have to compete that significantly because they want to have an alternative.

Chirag Dagli On longer-term basis we are already at 80% utilization. What is the longer term margin profile that you see of this business? Can it be as good as a speciality chemicals business?

Chetan Gandhi EBIT margin percentage we are looking at currently we are at say last couple of quarters and maybe Q4 we have been at 15% to 16%. We would like it to go up by couple of percentage point going forward. I think, depending on the product mix and we are also running CRAMs and CMO in intermediate as well as API, so how those orders we are able to get. So, everything will be depended on that but we would like to have interim target of 17-18 would be a good target.

Chirag Dagli And in the chemicals bit, over the longer term or maybe let us say over the next 2-3 years do you see any new chemistry that Aarti can potentially get in? Is there work happening around that front?

Rajendra Gogri Yes, we are this Chlorotoluene there will be lot of new chemistries. Coming in and as we have already announced we are expanding and putting up a new R&D center which will be started in New Bombay sometimes by the end of this year or the first quarter of next year. And we will be expanding substantially our chemistry capabilities, looking into lot of value-added products will get the benefit where have a more spread of chemistry knowledge. We are already getting lot of enquiries for different chemistries.

Chirag Dagli I missed the chemistry that you talked about. Was it Chlorotoluene?

Rajendra Gogri Yes, Chlorotoluene downstream has a lot of different chemistry than what we have for Nitrochlorobenzene and Nitrotoluene. There are chemistry of Photochlorination then oxidation and all that. There are different chemistries in that value chain and that already we have started doing R&D on that. So, in general we are expanding our chemistry capabilities.

Chirag Dagli Do you expect commercial manufacturing to start for any of these newer chemistries over the next say 3 years?

Rajendra Gogri Yes.

Chirag Dagli And the last bit on financials guidance for tax rate for FY19.

Chetan Gandhi Would continue to be around 19%-20%.

Chirag Dagli And the cost of borrowing?

Chetan Gandhi Should be sub 9.

Chirag Dagli So, there is no dramatic change for you in terms of the rate percent?

Chetan Gandhi No, sir.

Moderator Thank you. The next question is from the line of Vihang Subramanian from Ambit Capital.

Ritesh Ritesh here. Sir, just wanted to understand your volume growth a little better because as you said that last year, of course Nitrotoluene was not that utilized in second quarter of last year. And despite that we see and we do see some impact of China as well where probably demand would have benefited from that. So, despite that 10% volume growth rate is it just the mathematics around it? Or is it that something in particular which kind of, I mean 10% if I really look at Nitrotoluene which you would have added some percentage points to it as well.

Rajendra Gogri Yes, there we do on a weighted average basis. So, all the chemical products volume multiply by the price and then take the number. Because there are so many products with price of Rs. 5 to Rs. 2,500. And volume in 100 tonnes per day to 10-12 per month. So, that is how we do the volume growth calculation.

Ritesh Because I mean even if lets say look it at over a longer period of time, I mean your gross block has been growing almost 20%-25% for last 4 years if I look at FY15 to 19 CAGR. And then I look at volume growth rate of 10% to 12%. So it looks like, I mean even if I were to maintain the same asset turn and basically your pricing growth is what you are probably banking on. So, could you see a much faster volume growth rate in the coming years I mean you have said it is 15% but could it be more because you have been investing heavily over last 2-3 years or is it 15% is the what the number, we should work with.

Rajendra Gogri Yes, CAGR more than 15% that is what we are looking at. It can be in the range of 15 to 20 in these 3 years.

Chetan Gandhi Value-added product is more going forward, so that is how.

Ritesh So, basically volume growth rate is just one component of your growth and then of course, the mix change that you see is another bit, which should benefit?

Rajendra Gogri Yes.

Ritesh And would you able to quantify the mix change for this quarter, I mean I am extending a bit too far but if you could just quantify the mix change probably that you would be better?

Chetan Gandhi It will not be possible to give it right now.

Moderator Thank you. The next question is from the line of Ranjit Cirumalla from B&K Securities.

Ranjit Cirumalla Congratulations on a great set of numbers. I think, we have achieved several milestones in this quarterly results. So, my question is on these specialty chemicals margin front, we have seen of the kind of margins and you alluded that something of that would be more of structural. My question is that have we seen any specific changes to the product prices in this specific quarter or a quarter before? Or is it the case of that we have got a new pricing from this quarter onwards?

Rajendra Gogri No, as I mentioned there are certain which are structural and certain there are definitely there was a sudden margin increase because of the shortage in China. So, there is a mix of both. There is structural margin expansion, then margin expansion because of the exchange rate and market distribution and some shortage in China. This is all 4 factors playing in.

Ranjit Cirumalla The shortage in China is specific to this quarter or it has been happening over the last one year?

Rajendra Gogri No, it is more through this first and second quarter of this, more of a second quarter of this year.

Ranjit Cirumalla And my second question is more on the micro front. For the last couple of years we have been seeing several news flows coming from China about how the government have becoming stringent. But if you see over the last couple of weeks or couple of months that news flows seems to have died down and it is like more of a news flow that the government intends to become less stringent in order to aid the domestic growth. So, how do you see this change here? Would it be more, would it change the story for us or it is more of a noise for us?

Rajendra Gogri No, it may change marginally because the pollution directly affects the people's health. So, I do not see there will be any substantial dilution happening. There may be some marginal dilution that may have some impact in some of the products. But I do not see the charges total reversal of the policy by China on especially on environmental side.

Ranjit Cirumalla So the theme of the change that was there for the last 3 to 4 years should continue?

Rajendra Gogri Yes.

Moderator Thank you. The next question is from the line of Deeraj Dave, who is an Individual Investor.

Deeraj Dave Congratulations on a good set of numbers. Just want to get update on the two contract-manufacturing large orders which we have got where we are on project implementation? One for the agro input and the other one is from SABIC.

Rajendra Gogri Yes, that project both are under execution, right now. The agro intermediate will be commissioning in the FY20 second half and the other project in the Q4 of FY20.

Deeraj Dave And what is the amount of capital spending we have done?

Rajendra Gogri The second one is not significant, the first one some expenditure was already being done in that.

Deeraj Dave There also we see revenue coming over the period of time, let us say FY20 it will get over or commence so basically, we will be taking some five-six months kind of stabilization period then the revenue will kick in? How is that you see revenue growing on that side?

Rajendra Gogri So FY21 will be the first full year for that project.

Deeraj Dave And any further development on the similar line whereby international players are looking at getting into some kind of relationship with Indian player?

Rajendra Gogri Yes, we are looking this as a separate vertical as a business and looking for this kind of thing in the next few years, we are quite confident that we will have this kind of businesses happening.

Moderator Thank you. The next question is from the line of Chirag Dagli from HDFC Asset Management.

Chirag Dagly Given the significant capital requirement, how does dividend policy change this year and the next? In the past we have given 20%-25% of our earnings as pay out. How does this change over the next couple of years?

Rajendra Gogri Basically, we will continue to give the dividend but right now we are a little bit on a higher debt-equity so it has been lower but in general, the strategy of around 25% payout will remain.

Moderator Thank you very much. We will take that as a last question. I would now like to hand the conference back to the management team for closing comments.

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 or would like to know more about the company, kindly reach our Investor Relations desk. Thank you.

Moderator: Thank you very much. On behalf of Aarti Industries Limited we conclude today's conference. Thank you all for joining us Ladies and Gentlemen and you may now disconnect your lines.