Aarti Industries Limited

Q3 FY22 Earnings Conference Call Transcript
February 7, 2022

Moderator: Ladies and gentlemen, good day and welcome to the Aarti Industries Limited Q3 FY22 Earnings Conference Call.

As a reminder, all participant lines will be in the listen-only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during this conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note, that this conference is being recorded.

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

Shiv Muttoo: Thanks, Stanford. Good evening, everyone. Thank you for joining us on the Aarti Industries Q3 FY22 earnings conference call. We have with us today on this call, Mr. Rajendra Gogri, Chairman and Managing Director of the company; Mr. Rashesh Gogri, Vice Chairman and Managing Director; and Mr. Chetan Gandhi, CFO of the company.

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

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

Rajendra Gogri: Thank you, good evening and a very warm welcome to all of you attending this call. I hope all of you and your families are in good health.

I trust that all of you would have received the Q3 FY22 results presentation that has been uploaded on the stock exchanges website earlier.

First a review of our financial performance:

Based on the financial results of the year till date, we have delivered performance that reflects strong business traction across both our verticals and positions us to comfortably exceed our growth guidance as shared earlier this year.

Our Q3 revenues were at Rs. 2,636 crore. This includes the termination fees in respect of the first long-term contract to the tune of Rs 631 crore. As you would recollect, in the month of June 2020, we had received the notice of termination of this contract from the customer, appropriate disclosures related to the same were given immediately to the stock exchanges on June 15, 2020. This has resulted in higher EBITDA and profit before tax by Rs. 611 crore, net of currency mark to market and expenses.

Excluding termination fees, our Q3 revenues were at Rs. 2,005 crore, up 53% year on year. Revenue expansion during the quarter also includes the pass through of the substantial increase in raw material prices as well as fuel and logistics costs to our customers based on contractual terms. We continue to extend the growth momentum by engaging strong customer traction for our expanded manufacturing capacities across key product lines.

As discussed in the past, our reported EBITDA is the key monitorable data point as it neutralizes input cost variations. During Q3, our core EBITDA of Rs. 356 crore – netted off for termination fees – is once again the highest in our operating history, demonstrating the ability of the business to maintain margins by passing on to customers the substantial input cost inflation experienced during the reported period. Q3 EBITDA was also higher by 25% year on year. EBITDA growth was driven by higher capacity utilization, volume growth, favorable product mix and realizations.

Our profit before tax came in at Rs. 247 crore, after adjusting for the termination fee. This was up 18% year on year over Q3 FY21 and is also our highest ever profit historically.

In the speciality chemicals business, our core revenues without termination income came in at Rs. 1,657 crore, up 56% year on year. Segment EBIT of Rs 284 crore, net of termination income, for Q3 translates into growth of about 27% on YoY basis and about 17% higher on QoQ basis.

As you are aware, we have a pricing model wherein the variations in input costs such as raw material, fuel, logistics, etc are passed on to the customer and growth achieved on this parameter during Q3 indicates positive momentum in the business. This is in the middle of continuing rise in the prices of various key input commodities, fuel price increase and significantly high cost of logistics. We are watching the situations closely and continue to pass-on the impact to the customers, to the maximum extent possible, there are instances where we had to absorb some part of these higher costs. The current inflationary trend has also resulted in the increase in working capital, but our well capitalized balance sheet has enabled us to manage the situation well.

We saw a return of demand from established markets driving improved margins. During the quarter, shortage in the supply of Nitric Acid impacted volumes of Nitric-based products.

Now for the Q3 production update. Production for Nitrochlorobenzene was about 18504 metric tons compared to 16832 MT a year back and about 20347 for Q2FY22. Similarly, for hydrogenated products we have achieved production of 2878 MT compared to 2739 MT last year. On the Nitro-Toluene front, the production for Q3 was 3633 MT, compared to 3594 MT in the same quarter last year. During the quarter, the shortage in the supply of Nitric Acid, which is one of the key raw materials, impacted the volumes of Nitric-based products. We are also witnessing this shortage in the current quarter i.e. Q4 FY22 and are taking necessary steps to optimize the product mix.

Coming to the key projects for the segment, we are currently taking trials for the project related to the 2nd long term contract and expect to commercialize the unit in this quarter, i.e. Q4 FY22. The project related for the third Long Term Contract at Jhagadia, the NCB capacity expansion at Vapi, and expansion cum asset upgradation for our Acid Unit at Vapi, etc are expected to come on stream in FY23.

We witnessed the return of demand from established markets driving improved margins. With the positive traction for the segment across both Indian and Global markets, we expect to deliver steady performance improvements going forward as new facilities scale up volumes.

Our pharma business grew by 40% YoY to Rs. 348 crore during Q3. Here too, we passed on higher costs to customers to a major extent, resulting in topline expansion. Business improvements have been driven by higher volumes, improving efficiencies and entry into new APIs. We have established relationships with global generic pharma companies and continue to invest in the expansion of API and intermediates capacities. We have now attained larger scale in this segment and see further increase in volumes based on our new investments. Further business visibility in Pharma is based on higher volume from regulated markets, value-added products and new introductions of intermediate products.

Currently, trial runs are being conducted in the new expanded block at the USFDA approved API facility located at Tarapur. We target commissioning in the current quarter itself, that is before the end of FY22.

EBIT for the pharma segment for Q3 was higher by 10% year on year at Rs. 60 crore. This was also a sharp jump of about 46% over the preceding quarter, that is over Q2 EBIT, as specific issues witnessed previously are now largely resolved. Going forward, we expect volume expansion to be supported by robust margins in this business based on a pipeline of approvals across anti-hypertensive, cardiovascular, oncology and corticosteroids.

Now, an update on capital expenditure. We have incurred capex of Rs. 312 crore in the third quarter. We have now invested about Rs. 920 crore in the year to date and expect the annual capex to be around Rs 1200 - 1300 crs, which is within the range with our earlier capex guidance of Rs. 1,200 - 1,500 crore for FY22.

As shared earlier, we are also undertaking various R&D and innovation driven programs with 40+ products for Chemicals and 50+ products for Pharma in the pipeline that will drive our growth beyond FY25 and give us horizon visibility till FY27.

Now with reference to the update in respect of the proposed Demerger of the Pharma Business and allied activities, we would like to share that we had received the necessary principal approvals from the stock exchanges in last quarter and the application is now under process at NCLT. We expect the process for getting necessary approvals for said scheme to take another 4-5 months, which is inline with the overall timeline that we had shared earlier.

Before I conclude, I would like to reiterate that we are focused on building an augmented organizational framework that positions us strongly to capture strategic growth opportunities in our focused verticals. We have an expanded pipeline of projects currently underway, providing clear visibility to the business over the next several years. As India emerges as an increasingly significant global chemicals supply destination, backed by a supportive regulatory framework instituted by the government, our capex commitments driven by a well-capitalized balance sheet, will allow the pursuit of aggressive growth in line with the business blueprint.

In addition, our plan to create individually focused businesses in our two core verticals will further enhance value for all our stakeholders.

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

Questions & Answers

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

Surya Patra: Congratulations for the good set of numbers. The first question is on the terminal compensation that the Company has received. It was guided on previously and has come in on similar lines. The Company seems to be adequately compensated for the deal cancellation by the customer. However, in this process of deal signing and cancellation, where you were not getting real operational contribution from the transaction, did you lose anything in the process of either in terms of effort, time and such by which you could have possibly created something else?

Rajendra Gogri: No, basically now we will be utilizing this facility for other customers as we had guided earlier since the facility still remains with us. We have got this compensation and the facility will continue to be utilized, so I believe that we are fairly okay.

Surya Patra: On financial terms, it was better than any kind of expected compensation. Though possibly, could you have utilized your effort in a right and better direction?

Rajendra Gogri: Yes, but nobody had visualized that this kind of a thing would happen at that time. The partner had also spent a lot of money.

Surya Patra: Okay. On the margin profile – since the last 6-7 quarters that the Company has been getting the $5 million kind of a compensation amount, this was building up into our numbers. This, to some extent supported margins at a time when there were challenges. If adjusted for that, would the margin profile be ~17-18%? Prior to that phase, the margin scenario used to be 20%. Now, you have guided for a higher margin scenario of 25-30%. How should one bridge this equation from the current ~18% to +25% kind of margin scenario beyond FY24? From the current period to FY24, what would really drive that and what should the margin scenario look like?

Rajendra Gogri: In this quarter itself and in this year, the raw material price have substantially increased just like last year. Thus, the providing the margin profile becomes very difficult. In general, the new products are in the pipeline for which we will start the construction of a plant in FY23, they are more value-added products and will have a higher EBITDA margin at constant raw material prices.

You are right regarding the $5 million amount which we were getting due to the cancellation of this contract, that will definitely have a negative impact on margins. Although, in the longer term, the increase in margins will be driven on introducing newer value-added products.

Surya Patra: On the crude price which is now beyond $90/barrel – is this concerning? At this junction, would it likely be temporary and if not, would the Company be able to easily pass on the elevated cost?

Rajendra Gogri: Generally for crude price even, whether it is $90 or it crosses $100, inherently, we have a raw material pass through and are able to pass on the price increases either in the same month or maybe with a quarterly lag. We are not much concerned on that.

Surya Patra: On the first contract – the plant relating to this was likely to be commercialized adequately from Q3. Has there been a ramp up there or when would that be expected?

Rajendra Gogri: Yes, we have already started selling the material from that plant and I believe that it will be from FY23 that we could see a substantial ramp up. By FY24, we expect it to almost reach our targeted original volumes.

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

Rohit Sinha: In the presentation, it was mentioned a 25-30% growth for FY22. How should we see this number; now as on 9 months you are already towards higher top line growth and also taking into account the rise in product prices in the last one year?

Rajendra Gogri: Yes, we have already crossed the last year EBIDTA in the 9-month because top line sometimes becomes difficult as a percentage, guidance will be on EBITDA, PBT and PAT levels. On that basis, I think we are maintaining ~25-35% growth rate.

Rohit Sinha: Is there any reason for that or does it just remain there?

Rajendra Gogri: No, basically by 9 months, we already reached the previous year's 12-month number on EBITDA and PBT. Also, the top line growth is substantially more but the critical guidance is more on our EBITDA and PBT levels.

Rohit Sinha: On the compensation – as you have received money, what kind of cost was included in this, at the EBIT level, of Rs. 611 crore? As earlier guided, this facility would be used to export orders for other customers, how much revenue is the Company generating from that particular project; or how many customers get secured post this deal compensation?

Rajendra Gogri: There are FOREX and related hedging costs and also certain commissions that are to be deducted from the EBIT. Regarding the facility, we have already started with the export of products from this site and will be doing both – domestic sales and exports, going forward. We have already identified customers; the qualifications of the product have also been done with new customers.

Rohit Sinha: What is the investment that has been made in this; perhaps in terms of revenue from the investment in this project?

Rajendra Gogri: In a couple of years, we are looking at reaching for targeted volumes and should generate ~Rs. 400 crore plus in revenue.

Rohit Sinha: In Pharma, the growth was driven by growth in the regulated markets. How are the margins in these since it would be less likely to have higher margins here?

Rashesh Gogri: In Pharma, as we have expanded the capacity, in this quarter it will be coming online, there are several products where we are unable to meet the customer's demand. So, those demands will be picked up. Also, as you know, we are operating in steroid as well as anti-cancer chemistry – APIs. The number of players offering these kind of products are limited. Thus, here we anticipate reasonable margins to sustain for future. We are getting newer approvals every year for these products also.

Rohit Sinha: Would the overall margin profile be better than the current level?

Rashesh Gogri: Yes, we would like to maintain the 18-20% EBIT number.

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

Rohan Gupta: What would be revenue loss that is because of the shortage of nitric acid?

Rajendra Gogri: We have not worked out an absolute quantification like that. However, it maybe ~Rs. 50 crore.

Rohan Gupta: It was mentioned that there still is a shortage of nitric acid; would this impact the current quarter?

Rajendra Gogri: Yes, there will be some impact in Q4 FY22 also.

Rohan Gupta: There has been a very sharp increase in crude prices, even in the current quarter. Do you expect any delays in passing it on? Do you see a cap that there will be acceptance only up to a certain level from the customers' end, after which it could affect demand as the end-user industry may not be in a position to absorb that price increase? Did the Company reach that kind of a level, given that crude is close to $90-100 and may have put a lot of pressure on the end product's pricing? Could this have any margin pressure?

Rajendra Gogri: Most of the products which are made from our downstream products line are agrochemicals, polymers, paints and such. The impact of the increase, by the time the finished product is made and put through to the customer is factored in all the marketing costs . So, the price at the end of the customer in terms of the increase in crude oil and our intermediate price is not significant to impact demand. However, for some commodities like plastic – polypropylene, polyethylene and PVC, the immediate lag goes to the end user and there at times there is a push back on demand due to the increase in the price of the base polymer. Although, in our range of products whether the crude is at $120 or $60, it will not impact the demand.

Rohan Gupta: There is absolutely no problem from the customer in terms of demand?

Rajendra Gogri: No, there will not be an impact because there the ultimate products are $5, $10 or $15 kind of products and from the customer's end, they may be priced still higher. The variances generally stem up from the demand point of view.

Rohan Gupta: On the long term project that was terminated from the customer and the Dicamba derivative intermediates that the Company is making, you mentioned ~Rs. 400 crore of expected sales. Is there a timeline as to when you will be able to achieve this?

Rajendra Gogri: **Yes,** By FY24.

Rohan Gupta: Any guidance on the percentage utilization of this plant now and what is it expected to be in FY23?

Rajendra Gogri: This year, we started by giving it a trial in terms of qualification, quantity and such. It is difficult to give guidance for FY23. We should be able to guide on the target for the volumes here in our Q4 FY22 call.

Rohan Gupta: What would be the current debt number and the cash position? Also, in terms of cash accounting from fees, how much of that has been received in the current year?

Chetan Gandhi: Regarding the accounting for the fees, we had an advance of $25 million and the balance would be coming in the current quarter and that would be fully settled in the current year itself. The debt levels are at ~Rs. 2,700 crore as of the quarter end.

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

Abhijit Akella: Just wanted to clarify on the adjusted PAT excluding the termination fee, is it Rs. 242 crore?

Chetan Gandhi: No, that would be the PBT of Rs. 247 crore.

Chetan Gandhi: PAT would be at a company level; we will have to look at it on a consolidated basis only.

Abhijit Akella: So, the same ~18-20% tax rate on this, understood. Besides the Rs. 631 crore termination fee, would the Company have booked another $5-7 million this quarter as well, as part of the given accrual?

Rajendra Gogri: It's a $6.5 million, right, Chetan?

Chetan Gandhi: Yes, that's around $6.5 million, that's the last component for the quarter because the contract gets over.

Abhijit Akella: On the project, you mentioned that Rs. 400 crore is expected to be generated from it in the next couple of years. If I remember correctly, for the original projects the revenue projection was also Rs. 400 crore a year. So essentially in terms of realizations and margin, it seems to be in the same ballpark as the original contract? Is that correct?

Rajendra Gogri: I think they are both similar, it will not be exactly the same, but the margin maybe little lesser because the prices have increased in general, over a period of time; raw material prices have increased. At the constant top line some margin will be a little less than originally forecasted.

Abhijit Akella: Regarding the demerger, how much of the tax will be transferred to Aarti Pharma Labs?

Chetan Gandhi: We will have to look at the component when the actual order comes in. As on the appointed date, which was the 1st of July 2021, the debt was of ~Rs. 600-650 odd crore. I do not have the exact number, but around that number of debt would have gone. There were also some cash balances, so the component of the cash balance would also go there. Anyway, these numbers will have to be seen as on the effective date when the NCLT approvals comes in and the actual numbers at that point of time.

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

Amar Mourya: On the volumes highlighted did you say that NCB was 18,500 MT?

Chetan Gandhi: Yes.

Amar Mourya: What was the PDA volume?

Chetan Gandhi: The PDA volume was ~495, close to 500 MT.

Amar Mourya: What about hydrogenation, was it 2,785 MT?

Chetan Gandhi: No, that was 2,878 MT.

Amar Mourya: What about nitro toluene?

Chetan Gandhi: It was 3,630 MT.

Amar Mourya: What would be the DCB, MCB and TCB volume, i.e., the volume in chlorination?

Chetan Gandhi: I do not have that number right now, we would have to check it.

Amar Mourya: Did the PDA and NCB, both of the capacities get expanded in Q2?

Rajendra Gogri: No.

Chetan Gandhi: There was no expansion of PDA recently.

Rajendra Gogri: Yes. Recent expansion was chlorobenzene plant.

Amar Mourya: Last time, when discussed, I think ~Rs. 1,200 crore of a Capital wip is what you were looking for – NCB Rs. 150 crore, for USFDA plant ~ Rs. 400 crore and then the two dedicated projects ~Rs. 300 crore. Has the NCB plant been commissioned or it is in the wip?

Chetan Gandhi: It is yet to be commissioned.

Amar Mourya: Is it the same case with the USFDA plant also?

Chetan Gandhi: Yes, but that number was not Rs. 400 crore, it would be ~Rs. 100 crore plus.

Amar Mourya: I think you had said that land was bought for ~Rs. 200 crore and Rs. 200 crore what was being implementing for the expansion.

Rajendra Gogri: No, it was not Rs. 200 crore for land. It is not possible.

Chetan Gandhi: I guess, Amar, you got a bit confused. So, for Pharma, we have got land in Gujarat and over there the project which is going to come up would be of the magnitude of Rs. 350-500 crore. However, it is something which is going to come up and is not currently part of the WIP component.

Amar Mourya: Okay. On the CAPEX – you said that out of Rs. 1,300 crore, ~Rs. 922 crore got invested and would be sitting in the WIP. You also guided that ~Rs. 1,500 crore would be invested in FY22-23. What would be that CAPEX now?

Rajendra Gogri: No. Now for all the new projects and new product line the construction will start in FY23 at the location. From April onwards, we will see construction of the UMPP plants that we had guided on and also for dedicated chemistries.

Amar Mourya: On top of this, you have also guided from FY24 to FY27 for ~Rs. 3,500 crore of CAPEX?

Rajendra Gogri: Overall, we had guided for Rs. 4,500-5,000 crore over a 3-year period and out of that ~ Rs. 1,500 was for the existing, ongoing projects and Rs. 3,000-3,500 crore for the new, the greenfield kind of projects.

Amar Mourya: On the greenfield projects that are going to come, the chemistry there be either toluene or benzene, right? When you say high value, what kind of products would these be and what is the profitability that can be seen from them?

Rajendra Gogri: Yes, a lot of chemistries will be added, starting with toluene and benzene but it may be that 2-6 steps will be added. That is how sales to asset turnover will be less and the EBITDA margin will be higher. The products will be of multi-end use and will have, Agro, Pharma and dyes and pigments. It will have import substitution and be export driven where customer want to diversify the source.

Amar Mourya: I believe you said that you are looking for export as well as for the import substitution for this Rs. 3,500 crore CAPEX, which you are doing. How big would this market be in terms of the value today and how much of it can you address. In India, what will be the import value and what would be the export size?

Rajendra Gogri: Yes. For the chlorotoluene range, already ~Rs. 1,500 crore of imports are taking place in India. In general, we count the product that will be make normally 60-70% of the market share of imports to be taken up. That is broadly what we look at as the market share target or import substitution.

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

Vishnu Kumar: What are the projects that will get commissioned in FY23 and FY24? If I am not wrong, one is a 2nd long term project expected to be commissioned in FY23 and when will the 3rd long term contract be commissioned?

Rajendra Gogri: We have started the commissioning trials and expect the product to come out in Q4 FY22. This is for the 2nd long term contract, the commissioning of which is targeted for FY22 itself. On the 3rd long term contract, we are targeting to commission it towards the end of Q1/Q2 FY23.

Vishnu Kumar: On the 2nd long term contract – what are the expected utilization levels and when is this likely to be achieved? I understand that it is $1.5 billion over a 20-year period, so, could the run rate be assumed as $75 million p.a.?

Rajendra Gogri: We will see a sharp ramp up from the first year itself and in a couple of years, we should be able to reach the full capacity.

Vishnu Kumar: I believe that this CAPEX is completely funded by the supplier. Going back to the compensation, the margins would be much lower than the Company level, is that correct?

Rajendra Gogri: Yes.

Vishnu Kumar: On the 3rd long term contract – could it be ~$125 million and what is the margin expectation for this particular contract?

Rajendra Gogri: Yes, I cannot recollect but maybe ~25%-35%.

Vishnu Kumar: Would the ramp up of this 3rd contract be seen quickly; what is the ideal number to consider? If I am not wrong, it is gain, is ~$125 million over 10 years?

Rajendra Gogri: Yes, that will also ramp up by FY24; we expect both of those to be running fully.

Vishnu Kumar: Are there any other projects that will get commissioned? You would be seeing ramp up in FY24 for the projects that get commissioned like the NCB expansion, we just spoke about or the acid unit. Indicatively, what would be the expected revenue run rate in some of these projects?

Rajendra Gogri: Yes, that is what we guided for – by FY24 we expect substantial ramp up of this contract, as well as nitro chlorobenzene, chlorobenzene and all; our guidance was around 1.7-2x the top line as well as EBITDA and PAT over our FY21 numbers, those kind of things by FY24, we should be able to achieve.

Vishnu Kumar: On the volume growth – I know that the Company has steep revenue growth partly because of commodities. How has the volume growth been this quarter, be it exports or domestic sales?

Rajendra Gogri: Yes, as far as speciality chemicals is concerned, it maybe ~25% YoY because this value is 50% plus. We will have to check that number.

Vishnu Kumar: Was there any disruption or benefit to the Company in the export market particularly because Chinese companies were not supplying? We understand that many of them are coming back post the Winter Olympics which is currently on. Do you see some element of surprise that is in the export market on them come back?

Rajendra Gogri: No, we are not seeing that.

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

Kumar Saumya: Regarding the dispute on the termination fees – apart from this Rs. 630 crore that was received in Q3 FY22, were there any form of penalty fees received in the first half of the year?

Rajendra Gogri: Yes, in the first quarter, it was $4.5 million, in the second quarter it was ~$7 million and in the third quarter the figure is ~$6.5 million, in addition to this is the termination fee. That was the number. Chetan, will have number in crore also, right?

Chetan Gandhi: Yes.

Moderator: Thank you. The next question is from the line of Aditya Khaitan from Stewart and Mackertich. Please go ahead.

Aditya Khaitan: On the Rs. 4,500 crore of targeted CAPEX, out of that the newer segment CAPEX is ~Rs. 3,000-3,500 crore. You said to an earlier participant that you are targeting more towards the benzene and toluene chain only. Would you be able to break it up into segments, like the first segment is the chloro toluene, apart from that, which are the other segments being targeted?

Rajendra Gogri: Yes, it can be further value-added downstream products from dichlorobenzene chain and the nitro chlorobenzene chain. In addition to the entire chloro toluene chain some nitro toluene downstream products also will be added. Currently we have three benzene and one toluene chain, where we make the base product also. So, all value-added downstream products from these four will be added; the chloro toluene will be adding the base chemistry of toluene chlorination as well as the downstream.

Aditya Khaitan: On the crude oil prices – you said earlier also that the Company is comfortable in passing on prices at any crude oil price level. However, considering the upward surge of crude oil prices, hypothetically, out of 100 customers definitely so, 70-80 could absorb it, however, there would be 10-20% of customers which might reject. Are you witnessing anything like that?

Rajendra Gogri: As mentioned earlier, the ultimate products that are made get consumed by the end customer, which will be going into agrochemical or pharmaceutical use where all those values are very high. So, for these intermediates ~$130-140 of crude price will not impact demand at all.

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

Nitin Tiwari: On the compensation payment that has been mentioned in this quarter, is that something you have received or is it that has accrued to us and we are yet to receive it?

Chetan Gandhi: We have got close to ~Rs. 180 crore plus already with us as advance and the balance will come in the current quarter.

Nitin Tiwari: What was received in the previous quarters?

Chetan Gandhi: Yes. So, basically in the first quarter we had provided for around $4.5 million and the second quarter it was $7 million and the third quarter $6.5 million.

Nitin Tiwari: So, basically, out of this $18 million and the one time compensation you have received ~Rs. 180 crore of payment and rest would be pending?

Chetan Gandhi: Yes.

Nitin Tiwari: Regarding the 2nd and 3rd long term contracts – the commissioning of the 2nd long term contract is at the end of Q4 FY22?

Chetan Gandhi: Yes.

Nitin Tiwari: The commissioning for the 3rd one is at the end of Q1/Q2 FY23?

Chetan Gandhi: Yes, it should start in Q1/Q2 FY23.

Nitin Tiwari: You mentioned an EBITDA range for the 3rd contract. What would be the EBITDA range for the 2nd contract and the annual run rate of revenue here?

Chetan Gandhi: In the 2nd contract, the annual run rate that we had disclosed earlier, when the contract was executed, was in the range of ~Rs. 500 crore. As Mr. Gogri shared, it will have a faster ramp up and might take just couple of years for us to reach to that level. The EBITDA, because there is no interest component or other stuff which is charged, should be relatively lower. We will have to see the exact number but it will be in the magnitude of ~14-15% or so. We will still have to rework it because of a lot of numbers, including the raw material prices and couple of other input costs have gone through or have changed; but it should be in that 12-15% kind of range.

Nitin Tiwari: That means about 30-35% in the 3rd contract, that is what you are looking at in terms of EBITDA, right?

Chetan Gandhi: Yes, around that kind. So, this is based on the pricing, which was available at that point of time when the contract was signed. So, some of those, basis the input costs, which has gone up there could have seen some change in it, but I do not see substantial change. It is on an absolute basis, the EBITDA guidance would continue to be as what was guided earlier.

Nitin Tiwari: What are the segments that these two contracts are targeted at – are they catering to agrochemicals or dyes?

Rajendra Gogri: It is basically, specialty chemicals, we will not be able to guide you in anything further on that.

Nitin Tiwari: I was wondering because in the case of the 1st contract, it was meant for agrochemical production, right?

Chetan Gandhi: Yes. However, in terms of these we have certain restrictions and cannot guide beyond what it is, other than specialty chemicals.

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

Rohit Nagraj: On the total income from the 1st long term contract, what was the amount in 'rupees crore' for FY21 and for 9M FY22? Obviously, the termination fee is Rs. 631 crore.

Rashesh Gogri: So, you are talking in terms of the revenue, which has been generated?

Rohit Nagraj: No, sir. I understand during FY21, we were getting close to about $5 million, each quarter?

Chetan Gandhi: That was roughly around Rs. 140 odd crore for FY21.

Rohit Nagraj: If I add this $18 million dollars for 9M YTD, is it close to about Rs. 135 crore?

Chetan Gandhi: Yes and another ~Rs. 630 crore.

Rohit Nagraj: So total is ~Rs. 900 crore is what you have received.

Chetan Gandhi: Broadly, around that.

Rohit Nagraj: On the long term contracts – you have given a range of revenue growth from FY24 to FY27. By FY24, what percentage of the revenues might be coming in from the long term contracts and similarly, FY27?

Rajendra Gogri: The long term contracts' percentage will increase with the two new contracts and also some more contracts are being discussed; but our non-contractual sales will also increase. So, overall, we have not done any specific bifurcation between these long term contracts. In general, most of our products have very good visibility with the customer about their next few years demand, how they are going to grow and how much they will be buying from us, in that sense. But the long term contract percentage is increasing.

Rohit Nagraj: So, whenever we discuss long term contracts, the project execution period is for 2-3 years or is it now lesser than that; given that we already have a particular asset size and ongoing projects?

Rajendra Gogri: Yes, it depends. If it is a greenfield, then it takes more time, if it is a brownfield then obviously, it is faster because we have a lot of infrastructure in place. So, it depends on that and on also the complexity of the project and the total CAPEX involved. Thus, it will be anything between 1.5-3 years, depending on the size of the project and whether it is a greenfield or brownfield project.

Rohit Nagraj: On R&D – currently, what is the strength; what is the headcount of PhD and technology-related employees in R&D?

Chetan Gandhi: I guess the headcount would be upwards of 400 people; we will have to do a recent head count.

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

Naushad Chaudhary: So typically, on long term contracts, there is a commitment from your side in terms of the project commissioning and supply on time. At the same time, there is a commitment on the client side on the volume off peak, right?

Chetan Gandhi: Yes.

Naushad Chaudhary: I see the commissioning timeline of both of the long term contracts (2nd and 3rd), there has been a substantial delay Initially, the 2nd contract was expected to come by Q1 FY21, it has been delayed by ~2 years. Similarly, a delay of ~1-1.5 years in the 3rd contract. Who is delaying and what is the reason for this delay? Is the client is not pushing the Company to get it on time/quickly? Is this an indication that the ramp up of these two contracts could be slower than expected and there is not much demand for the product from the client?

Rajendra Gogri: This delay was mainly because of the two waves of COVID and that was a global occurrence. So the 2nd contract was already reset by one year, because of COVID. We are in constant touch with our customers, even regarding the delay which was happening on that plant. On the ramp up, we do not see any issues. Also on the demand from the customers, they do not see any challenges going forward.

Naushad Chaudhary: Can the annual revenue run rate be expected to come within 1-2 years or the full utilization of both the contacts once it gets commissioned?

Rajendra Gogri: Yes, by FY24, both will reach an almost full run rate.

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

Rohan Gupta: On the capital employed in the Chemical's business and in Pharma – gross block has gone up and investment has gone up significantly, which I believe is a combination of CAPEX…It seems looking at the numbers like there has been close to Rs. 1,800 crore in asset increase from Q4 to Q3, while liabilities has gone up only from Rs. 200 crore. So, just wanted to understand that because of the high input prices, the debtor have gone up significantly in inventories also, but are we not getting enough lineup from the payables? Is there any significant increase in working capital that is going to affect your interest cost in the current scenario?

Chetan Gandhi: So, Rohan just to address the question probably against the increase of Rs. 1,800 crore, Rs. 900 crore is on the capital spend which is there, there will be Rs. 600 crore related to the termination which is also shown as receivable and part of capital employed. The result would be on the working capital side.

Rohan Gupta: So, even the Rs. 600 crore is also included in that?

Chetan Gandhi: Yes., it is because we still have to receive a substantial part. So, there will be a good part of that also as a part of capital employed, right?

Rohan Gupta: As part of this termination contract arrangement, the balance money was supposed to come by end of FY22. So, this balance of Rs. 600 crore, the entire money, would it come in the current quarter?

Chetan Gandhi: Yes.

Rohan Gupta: Okay and that will lead to total money received from this contract termination of Rs. 980 crore, because that actually was one $140 million, right?

Chetan Gandhi: No. We had given guidance that it would be in the range of $120-130 million and the numbers are within the guidance which we had given in June 2020.

Rohan Gupta: Through the product which like Dicamba derivative only, you mentioned that you can achieve a revenue potential of ~Rs. 400 crore, which was actually full revenue potential from this contract when it was done with Monsanto, with an 40% kind of margin. Do you see that at full potential when you are selling this product, still having a 40% kind of margin?

Rajendra Gogri: No, it will be lower but not very much lower, I would say.

Rohan Gupta: So, even though we may achieve revenues, in terms of margin profile it will be much lower.

Rajendra Gogri: No, not much lower. It will be a little bit lower; I would say but not of 40%. It will be more between the 30-40% range.

Rohan Gupta: Being almost at the end of the year and having invested close to Rs. 950 crore in CAPEX by Q3, the range for the current year still looks pretty large in terms of the CAPEX of Rs. 1,200-1,500 crore for the current year with only a couple of months left for this year. How much will be the CAPEX for the current year and are there any spillovers or delays that you are expecting?

Rajendra Gogri: Actually, we have recorrected, in our statement now, we have said Rs. 1,200-1,300 crore, right, Chetan?

Chetan Gandhi: Yes. Rohan probably you would have missed out, when you were dropped out..

Rohan Gupta: Okay, because I was just referring the presentation, where the annual guidance of Rs. 1,200-1,500 crore is mentioned.

Rajendra Gogri: Yes, that was the annual guidance and now 9 months are over. So, we are now looking at around Rs. 1,200-1,300 crore.

Rohan Gupta: So, in that context, can we be concrete about next year's CAPEX plan?

Rajendra Gogri: No, next year, we have to still workout in detail regarding the cash flow. Overall, the 3-year guidance that was there of Rs. 4,500-5,000 crore, that is for sure.

Rohan Gupta: When you say 85% utilization in specialty chemical for the current quarter. Can you give what was the gross block number that was considered?

Chetan Gandhi: Rohan, I'll have to check that number. I do not have it right now handy with me, sorry.

Rohan Gupta: Okay. However, definitely the entire Rs. 950 crore invested in the current year would not have been part of the 85% utilization?

Chetan Gandhi: Substantial part of this is in capital WIP, those projects are yet to be commissioned.

Moderator: Thank you. The next question is from the line of Bob from Falcon. Please go ahead.

Bob: Do you see any new competition coming up given the growth in this sector, in India especially?

Rajendra Gogri: Yes, we have a very wide product range and have some competitors in India as well as in other countries. Overall, we do not see any significant increase in competition.

Bob: So, you have not had other chemical manufacturers getting into benzene derivates, recently?

Rajendra Gogri: No, not yet.

Moderator: Thank you. Ladies and gentlemen, we take the last question from the line of Surya Patra from Phillip Capital. Please go ahead.

Surya Patra: Under your R&D projects, around 40 odd products are there in that chemical pipeline and ~25 odd in Pharma. Can you elaborate on that a bit?

Rajendra Gogri: Yes, 50 plus in Pharma.

Surya Patra: So, that number would be here. I'm saying on the pipeline if you can just give some clarity on that?

Rajendra Gogri: Yes. So, chloro toluene and its downstream products as well as downstream products of nitro chloro and dichloro benzene, nitro toluene. So value-added, downstream products are in the product range.

Surya Patra: You had earlier mentioned about when, while setting up the new R&D plant in Navi Mumbai. You had mentioned about new areas.

Rajendra Gogri: No, chemistry-wise. There are a lot of new chemistries, these are the products which are downstream. In the chemistry. we will be having photo chlorination, ammoxidation, then AHF Fluorination, Grignard reaction, so a lot of new chemistry will come in.

Surya Patra: In terms of application, majorly how would that be distributed?

Rajendra Gogri: It will be both, Agro as well as Pharma, product going into start runs, some in dyes and pigments. It has a very wide range of applications, but these three sectors will be the major ones – Agro, Pharma, some dyes and pigments and some other sectors.

Surya Patra: In Pharma – on the manufacturing side, how integrated would you be post this pipeline?

Rashesh Gogri: So, basically in Pharma we are largely up to the 'N-5' stage. On most of the APIs that we manufacture, we are doing, more or less, in-house manufacturing, except the steroid range of products. In certain products like sitagliptin, etc. we will be vertical from benzene straightaway till the final sitagliptin. That is one example or there could be similar few examples of few APIs, but that value, in terms of turnover may not be significant. But as a practice generally we try to do at least 5-7 stages in-house in Pharma for non-steroidal products.

Surya Patra: So how would the business model of Aarti Drugs be different from this as that is also into APIs?

Rashesh Gogri: So, basically what we are doing in Aarti Industries is largely specialized chemistry of steroids, anti-cancer as well as the antihypertensive and lifestyle medicine. These are higher value and lower volume products that we are targeting and we do not generally do products which are below $100 a kg. Aarti Drugs, is largely where we are into ciprofloxacin, anti-infective and pain management.

Surya Patra: Sir, large volume, old product?

Rashesh Gogri: Yes. So, these are all older products where the values of certain products are about $100 but largely under $100. However there are some products which go up to $300-400 also, but largely in that space. Aarti Drugs is focused on ROW market, whereas here in Aarti Industries we are focused more on the regulated markets as well as we are also selling intermediates of these APIs to all the generic manufacturers, who are companies like Dr. Reddy's, Mylan, Zydus or Alembic and they buy intermediate for their regulatory requirements. Apart, from that we also have a CDMO business in Pharma, which is a different business that Aarti Industries does not have.

Surya Patra: Then in terms of manufacturing facilities, so it is entirely batch processed?

Rashesh Gogri : Yes. We have fully flexible manufacturing where we can do a multipurpose production with multipurpose plants, manufacturing any product which fits that manufacturing location. So, it is a facility where we can change the product and go to different product if , say, in the particular product suppose the market is down due to lifecycle, etc., then we can always substitute it with a new product. In the case of Aarti Drugs, that is a little bit less possible, but of course, doable.

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

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

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