Aarti Industries Limited

Q3-FY20 Earnings Conference Call Transcript
February 13, 2020

Moderator: Ladies and gentlemen, good day and welcome to Aarti Industries Limited Q3 FY20 earnings conference call.

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

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

Shiv Muttoo: Good afternoon everyone and thank you for joining us on Aarti Industries Q3 FY20 earnings conference call. We have with us on this call Mr. Rajendra Gogri – Chairman & Managing Director, Mr. Rashesh Gogri – Vice-Chairman & Managing Director, and Mr. Chetan Gandhi – CFO of the company.

Before we begin the call, I would like to point out that some statements made in today's call may be forward-looking in nature, and a disclaimer to this effect has been included in the results presentation shared with all of you earlier. I would now like to invite Mr. Rajendra Gogri to take you through the performance of the company and his outlook on the business. We will then open the forum for an interactive Q&A session. Over to you Mr. Gogri.

Rajendra Gogri: Good afternoon and a very warm welcome to all of you. Our financial performance during Q3 is in line with the guidance given earlier (during the last call). From the revenue standpoint, there are a couple of key points that need to be considered when we look at the performance for the quarter. We have carved out revenues from the erstwhile Home and Personal Care segment which will be listed as Aarti Surfactants. In Q3 FY20, we witnessed a sharp increase in the raw material pricing, trailing the crude price increase on account of the increased tension between US and Iran. This price increase was passed on to the customers resulting in an increase in the top line. As a consequence, this sector reported revenues that are higher compared to the Q2 FY20 and flattish as compared with the same quarter last year. Export remained relatively stable contributing to over 40% of the total revenue. Overall, we see this as positive performance from the perspective of our longer-term business objectives amidst macro challenges.

Our gross profit and operating profit are the more appropriate parameters to evaluate our business and these were largely stable on a YoY basis. On the lower base of revenues, reported margins have expanded significantly. The PAT for the quarter grew by 3% YoY to close at Rs. 137 crore. These numbers need to be looked at the backdrop of continuing macro challenges in the US Agrochemical and global Automobile sectors.

Aarti Industries, with differentiated capability, relationship and wide range of chemical products continues to be well recognized by most of the largest customers globally. We maintain a low concentration on geography, client and product parameters, thereby significantly de-risking the business.

Our standalone Specialty Chemical business revenue was marginally lower by 1.2% YoY in Q3, however, was higher by 19% on a QoQ basis. This was on account of increased volume of Nitrotoluene products and also due to the raw material price increase which was witnessed in Q3 versus Q2 FY20.

As explained earlier, the impact of certain end-user segments were felt on the demand of various products, despite that the company was able to report the segment EBIT of Rs. 205 crore for Q3 FY20 as against Rs. 210 crore for Q3 FY19 and Rs. 200 crore for Q2 FY20.

We have been continuously leveraging our fungible capacity to optimize our product mix to maximize the EBIT. Contribution from downstream products further increased from 70-75%, which is a trend driving our business to the next level of customer engagement and into segments that see relatively less competitive intensity.

We produced about 14,900 metric tonnes of Nitrochlorobenzene during Q3 FY20 as against 17,765 metric tonnes for Q3 FY19.

We had discussed during the last call that – there was a temporary shortage in the key material – Nitric acid, which had originated during Q2 FY20 and will prevail till October 2020. This impacted the volume of some of our products.

Our major on-going projects such as Specialty Chemical complex, Chlorination plant in Jhagadia and projects at Dahej SEZ in Gujarat are progressing as planned and are expected to be commissioned in this quarter. Likewise, our fourth R&D and scale-up center which is coming up at Navi Mumbai is going to commence activity during this quarter. This center will facilitate further enhancement of product portfolio and also help improve our manufacturing processes.

The Pharma business showed a marginal increase in revenue on a YoY basis; however, the EBIT for the segment grew by over 20% to Rs. 36 crore for Q3 FY20 as compared to Rs. 30 crore for Q3 FY19. This is partly attributed to the continuing change in product mix towards higher value addition which is evident from the strong growth in profitability both on absolute basis and as a proportion of revenue. Segment margin expanded by more than 300 basis points to 20.4% with overall capacity utilization that has been running at higher levels due to some lines being occupied by new products where we are undergoing a validation trial.

On the CAPEX front, we had invested Rs. 830 crore during the 9 months period and are on track for the planned full year CAPEX of around Rs. 1,200 crore. The company continues to operate at a healthy gearing level and would utilize the remaining surplus cash flow from the QIP fundraise for the on-going CAPEX program during this year.

Summarizing on our performance, despite macro challenges, we have been able to achieve consolidated PAT of Rs. 426 crore for 9 months FY20 as against full year consolidated PAT of Rs. 491 crore for FY19. Looking at this in the current situation, we are confident to be able to meet our guidance of bottom line growth of about 10-15% for the year.

To conclude, we believe that India is emerging as a more significant player in the global Chemical supply chain with its scalable low-cost manufacturing ecosystem, improving infrastructure and established robust compliance framework. The country is well positioned to expand its market share globally. There are also opportunities to replace imports with domestic production. Investments into operational excellence and new product development can create differentiation and strong long-term business visibility. We are making several initiatives and investments to participate in this growing potential.

On that note, I conclude my opening remarks. We would be very happy to give you our perspective on any questions that you may have. I request the operator on this call to open the question and answer session.

Moderator: Ladies and gentlemen, we will now begin the question & answer session. The first question is from the line of Surya Patra from PhillipCapital. Please go ahead.

Surya Patra: Congratulations for the good set of numbers. Sir, just a couple of clarifications about the global opportunity that you talked about in the opening remarks- seeing the situation that is prevailing in China, the capability of India, as you pointed out and your initiative to play an important role in the global business, could you highlight the incremental initiative taken to play an important role there? Do you see any benefit because of the China situation; either because of price or volume advantage, in the near future?

Rajendra Gogri: There is a growing appetite for sourcing from India. Volume demand, for Indian and global consumption, continues to remain high (from India). People are now looking at supply chains which are altogether independent of China, where in no intermediate is from China. Thus, companies like ours – that are completely backward integrated in the chemical business with no import from China are in a more advantageous position. That demand appetite is definitely there. In terms of margin appetite, as the Chinese costs have increased, Indian margins have expanded. If there are short-term shortages, it can give a short-term spike. In general, long-term secular margins have expanded.

Surya Patra: Sir, on the price behavior of chemicals – because of the situation in China, there is a general perception that it would lead to a shortage; this would further result in a meaningful spike, as witnessed last year. Against this is a contrarian theme that – China, being one of the largest chemical markets has seen demand being significantly low and the crude price being significantly low, compared to the earlier situation. Given that there is a meaningful lower demand situation which is keeping prices lower (against the thought process of spike) likely because of the supply disruption, have you seen any kind of a price behavior which is favoring us or something similar in the global market, sir?

Rajendra Gogri: Due to the situation around the Coronavirus, there is a demand for chemicals and product to product margin expansion can be seen. As far as the demand from China itself is concerned, unless those consumption plants are impacted, the overall demand for goods will not be impacted much. Currently, it is the services that are impacted within China. We have not seen any Chinese demand reducing in a way to have an impact on global production; but on a short term basis – crude, oil and the bulk commodities being highly volatile, give the response of volume reduction. Speaking on value-added chemicals – it is not expected to have much impact on the global demand.

Surya Patra: Over the 9 months, what is the volume growth that we have seen on the export side?

Rajendra Gogri: Export this quarter was 40%.

Surya Patra: In terms of volume growth?

Rajendra Gogri: We do not provide volume growth data but provide a value-added percentage.

Surya Patra: Looking at exports, what is the trend that the Company is witnessing? This is to assess the volume growth in the export market that you have witnessed.

Rajendra Gogri: With the commencement of new projects, there will be a huge jump in exports as they are on 100% export terms. On the regular business – as mentioned in the past, downstream consumption has started to witness an increase in India. Thus, the demand for the regular business is growing both in terms of domestic sales and exports.

Surya Patra: On the supply deals – the Agro supply deal which was supposed to initially commence from the 4th quarter and the Polymer supply deal which was likely to commence in the 2nd quarter of the next year; is there an update on the timeline? In what manner will the ramp-up happen – should we expect instant/evenly distributed revenues from the first year on, or would there be a gradual ramp-up for the deals?

Rajendra Gogri: The plant will be commissioned in Q4 this year; for both the projects, the ramp-up will be gradual in the first year.

Surya Patra: A delay in the customer's (own) project would not impact the Company?

Rajendra Gogri: In the first year, the ramp-up will be slower and gradual.

Surya Patra: About the margin performance for next year – considering the lower crude prices that are likely to prevail in the near future, there has already been an improvement in terms of the value-added product contribution and the underutilized operation of new projects in the next year. What is the trajectory that one should look at; looking at the first 9 months, the margin is slightly more than 22% that has been reported.

Rajendra Gogri: Margins will improve because the value-added production is expected to increase in FY21 and FY22. So, margin as a percentage, even in the constant raw material prices is expected to increase.

Surya Patra: The underutilization of the newly added assets would not impact the margin that has been guided for – is that correct?

Rajendra Gogri: Yes.

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

Naushad Chaudhary: If you can share the volume number – you have shared the NCB production number and can share the remaining i.e., Hydrogenation, PDA, and Nitrotoluene production numbers of this quarter?

Rajendra Gogri: Yes. Hydrogenation numbers were 2,330 tonnes per month, PDA was about 417 tonnes per month, and Nitrotoluene was 1,666 for the quarter.

Naushad Chaudhary: Nitrotoluene last quarter was around 4,000. If this number is correct then there is a sharp decline in the production number.

Rajendra Gogri: Nitrotoluene last quarter was 1,363 for the entire quarter.

Naushad Chaudhary: Would you have the balance sheet numbers on the inventory and debtor days?

Chetan Gandhi: Yes.

Naushad Chaudhary: What are the current inventory and debtor days?

Chetan Gandhi: The current inventory days are around 61 days and the receivable days would be around 73-75 days.

Naushad Chaudhary: In the last quarter, there were issues relating to raw materials in the Pharma business that impacted the overall inventory. What is the status now?

Chetan Gandhi: Considering the challenges that the Company has witnessed on the materials coming in from China, there was an additional inventory created for some of those products – more from the perspective of pollution and other regulatory issues in China. In the current situation, to an extent, that inventory position would help to mitigate the requirement with roughly more than a quarter of inventory in stock at this point of time. Thus, the strategy could probably be continued.

Naushad Chaudhary: Is there an alternate source, apart from China, for those raw materials? Would we have an alternate source if the Coronavirus was to affect that supply chain system?

Rashesh Gogri: The Company is focusing on aggressively developing Indian sources for all of its raw materials to mitigate risks. Although, for products like – *steroid intermediates,* they are not produced in India and the technology for developing them is also unavailable. Thus, there will be dependence on China. This is the current scenario. We have been in contact with the suppliers and hope that the situation would resolve by early next quarter. The suppliers are also hopeful that the situation will improve in another month/ month and a half. Since the inventory is being received, there should not be any major issue. In certain products, like *steroids*, about 10% to 20% of production may get hampered, but otherwise, there should be no issues.

Naushad Chaudhary: Would that be 10% to 20% of the Pharma business?

Rashesh Gogri: The percentage is pertaining to the *steroid* segment. If the situation continues beyond 1-1/2 to 2 months, then we may face some challenges. Albeit, everyone is hopeful that the issue will resolve; let us see.

Naushad Chaudhary: After placing an order for these raw materials, how long does it take to reach the factory i.e., start to end?

Rashesh Gogri: The Company has annual or quarterly contracts for key raw materials. Thus, the orders are already registered with the suppliers. We receive the product soon after they produce and ship it.

Naushad Chaudhary: How long does it take for the product to reach the Company i.e., from the supplier's gates to the Company's gates?

Rashesh Gogri: It takes a period of 20 to 25 days.

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

Ritesh Gupta: Chetan, could you update us on other CAPEX initiatives that the Company is undertaking apart from the two contract manufacturing projects that are supposed to be commissioned in Q4? There were other projects which were in the pipeline; if you could provide an update on that?

Chetan Gandhi: As regards to the 3rd long-term contract – the commissioning was targeted for March 2021 and is on track for the same timeline. On the other major project – an NCB project, its commissioning should be towards the end of FY21.

For some of these projects, there are certain delivery items, ordering and the like. We would need to take stock to give a more detailed update by next quarter; as of now, it should fairly be in the similar timeline.

Ritesh Gupta: Pertaining to the next 6 to 9 months, apart from the contract manufacturing projects, are there no other major CAPEX projects that get commissioned in the next 2 to 3 quarters?

Rajendra Gogri: Yes, these major projects will get commissioned now. There will not be any major project being commissioned in the subsequent two quarters.

Chetan Gandhi: In addition to that, the expansion initiatives will be commissioned at the Pharma US FDA site in the next financial year. As of now, no larger project will be commissioned next year.

Ritesh Gupta: On the two contract manufacturing projects – they are to see a ramp-up in the second half of FY21. Thus, would it be correct that – the first half would be more of a ramp-up phase and then second half would see the revenues?

Rajendra Gogri: Yes, the utilization will improve in second half.

Ritesh Gupta: On the Pharma side – there was talk about expansions into a couple of other therapies; if you could elaborate on that. What would be the CAPEX and the growth trajectory that you are looking at over the next 2 to 3 years?

Rashesh Gogri: In the Pharma segment – the focus is on some of the anti-diabetic (newer age drugs), Flogene and also anticoagulants; 2-3 drugs have been taken up for R&D. These are the new products that are a part of our 12 product portfolio which will get validated over the next year or so. A project for an additional block of API manufacturing is under implementation at the Tarapur site and would save CAPEX of around Rs. 75 crore. These are the products that will get commercialized over the next 3-4 years. In terms of intermediates manufacturing, we are also going to commercialize one additional block of production at our Custom Synthesis plant and that will also add around 15-20% capacity for intermediate manufacturing. These two will add for the next year's capacities.

Ritesh Gupta: There is no raw material related impact from the second quarter into this quarter on the Specialty Chemicals side. Would that be correct?

Chetan Gandhi: The situation around Nitric acid was discussed during the last con-call. It will continue till October. On the supply side, that was the only product which impacted the Specialty Chemicals segment.

Ritesh Gupta: Both of the projects are expected to get commissioned in the 4th quarter; would you have the exact commissioning dates?

Chetan Gandhi: Not as of now.

Ritesh Gupta: Is there a possibility that they could get spilled over to the 1st quarter of next year?

Rajendra Gogri: No, it will get commissioned in the 4th quarter, this year.

Moderator: The next question is from the line of Chetan Thacker from ASK Investments. Please go ahead.

Chetan Thacker: What would the NCB production volume for the quarter be?

Chetan Gandhi: It was 14,900 tonnes.

Moderator: The next question is from the line of Rahul Jain from Lionrock Capital. Please go ahead.

Rahul Jain: On the two long-term projects – were there any discussions from the customers, given the macro situation, on changing the ramp-up timeline at all? The first year of ramp-up is expected to be gradual – is it the nature of this contract?

Rajendra Gogri: In the first year, the ramp-up is expected to be gradual.

Rahul Jain: Would it be driven by the customer's request or due to the nature of the contract? Is it typically done slowly when a big plant is commissioned?

Rajendra Gogri: The customer will be commissioning their plant simultaneously. Thus, the ramp-up in the first year is expected to be slower.

Rahul Jain: Would both of the plants be commissioned in Q4, before March 2020 or would one of them be in March 2020 and the second 3-6 months later?

Rajendra Gogri: Both of the projects will be commissioned in Q4 FY20. The second project has been split into two different product lines and hence, will be in two phases.

Rahul Jain: Sorry, I did not understand about the second project.

Rajendra Gogri: The second project has been divided into two parts. The first part will be commissioned in Q4 and the second may be commissioned after the second quarter.

Rahul Jain: On the supply disruption in China – are there products that have seen a significant spike in prices or is there not much of an impact i.e., in terms of your profit margins/ prices for some of the products?

Rajendra Gogri: There is a general impact that can be seen in the demand of some products which may lead to a price increase. The impact may be seen towards the end of this month, i.e., when the situation will develop.

Rahul Jain: Looking at the overall EBITDA or operating profit – from the last 5 or 6 quarters, the EBITDA has been about Rs. 240-250 crore. Would we continue to see the same EBITDA till the benefit of the new contract is realized or would there be an increase in accordance to the ramp–up of the long-term contracts, possibly in the second half of next year?

Rajendra Gogri: There would be some ramp-up in the first two quarters. The ramp-up in volumes will continue because of another product line of – Nitro-toluene and PDA. Thus, the second half will witness a substantial ramp-up and volume growth than the first half.

Rahul Jain: The profits will likely be at 10-15% this year, largely driven by lower finance costs. Operating profits are largely going to be flattish; which have generally been growing at mid-high teens or probably closer to 20%, consistently. What would be the reason for that? Would it be a one-off or would it be due to structural changes?

Chetan Gandhi: When we look at the numbers, we have to factor or consider the facts that – in this year, for a period of 3 months, there was shortage in Nitric acid – which is one of the key raw materials that impacted volumes to an extent. Also, there were issues in the US, relating to floods, which impacted the Agrochemical demand for various products. The third fact was the global Polymer application, for the Automotive and all linked with them in the Automotive sector, also impacted demand. These are the factors which have actually impacted the demand on a lower side, plus – the shortage of raw material that impacted production capabilities. Despite the mentioned challenges, the EBITDA numbers have still been maintained at a higher level.

Rahul Jain: There was news related to tax issues at the Company; if you could comment on that?

Rajendra Gogri: It is still under process; although, not much of an impact is expected from it.

Rahul Jain: What exactly happened; since there was not a press release from the Company?

Rajendra Gogri: The authorities arrived and collected certain data to analyze; they will come back to us. Overall, we do not see much of an impact. As of now, there will not be any clarity either.

Moderator: The next question is from the line of Sneha Talreja from Edelweiss. Please go ahead.

Sneha Talreja: Could you quantify the impact of – price benefits, in the current quarter, specifically related to the PDA chain?

Rajendra Gogri: This quarter, it will be around Rs. 10 crore.

Sneha Talreja: Do you expect this to sustain? It was mentioned that the near peak was in Q2 which was around Rs. 15 crore, odd. Although it has come down, would this figure be maintained?

Rajendra Gogri: It should continue in Q4.

Sneha Talreja: Is this trend prevalent for other products, given the current situation in China?

Rajendra Gogri: The impact of the Coronavirus on the prices, will likely start to crystallize towards the end of this month. It would actually have a positive impact on the Chemicals' business.

Sneha Talreja: The Pharma segment's margin has seen continued improvement. A couple of quarters ago, there was a mention that these margins should peak around 21%, odd, in the coming year. Where does it stand now and would there be scope for expansion?

Rashesh Gogri: The margins this quarter have been at 20.5%, largely driven by low cost in raw materials and overall product mix which was driven by high-margin products. New plants that are coming in will also have an overall impact. Low-margin products will also be considered to fill capacities. It will eventually stabilize at around 20% / 21% / 22%. The new capacities will come in the next year.

Sneha Talreja: Any quarter-wise guidance for next year? When are those plants are expected to commission?

Rashesh Gogri: The API block expansion is going to be more towards the second half of next year and the Intermediate block expansion is happening in first half of next year. We are still in the process of budgeting. Guidance on the next year could probably be given in the next quarter.

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

Vishnu Kumar: In terms of the next year's supplies – across the Company's customers, what is the feedback that you are getting, be it Auto / Agri or other segments which we are selling to?

Rajendra Gogri: The impact of the Agro in the US will gradually increase and is expected to normalize in the second half. We are still to see how the situation pans out for Automobiles.

Vishnu Kumar: On an organic basis, would it be at mid-single digits or much higher?

Rajendra Gogri: For the next year?

Vishnu Kumar: Yes.

Rajendra Gogri: No, with this contract kicking in, it will be towards the higher double digits.

Vishnu Kumar: On the Agro contract – the innovator is delaying the technical plant startup to probably early next year. Would this mean that the ramp-up will only be in the second half or would you still supply to them perhaps to use at another location?

Rajendra Gogri: As mentioned before, the ramp-up would be slower and would be a gradual ramp-up in the next year.

Vishnu Kumar: If the current situation in China continues, the chemical business will be a net beneficiary. Would that be correct?

Rajendra Gogri: Yes.

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

Rohit Nagraj: About the two contracts, it was mentioned that the ramp-up in FY21 would be gradual. Would you expect to reach the full potential Rs. 400 crore of revenues and Rs. 500 crore of revenues from the two contracts in FY22?

Rajendra Gogri: Yes, FY22 will be substantially be higher and FY23 will be virtually full. FY22 may be more towards 80% plus of potential.

Rohit Nagraj: Would the potential for FY21 be lesser than half or closer to +/-50%?

Rajendra Gogri: Yes, it would.

Rohit Nagraj: In terms of a broader strategy – the contracts will start kicking in and adding to growth for the next couple of years. Beyond this, would we have any other such new contracts or any other areas of expansion from chemistry perspective?

Rajendra Gogri: Yes, the third contract has been signed and will get commissioned in Q4 FY21. In addition to that, we are looking at expanding in the Chlorotoluene range of products – chlorotoluene as well as downstream – where we will be adding a new chemistry; also of Photochlorination, Oxidation and the like, which will be a newer range of chemistries. With the expansion of the R&D facility, as well as the R&D talent ramp-up, there will be an addition of quite a few chemistries going forward. As mentioned earlier, there is a huge appetite for value-added products for supply chain which is totally independent of China. People want us to supply products worth $70 to $80 and these products require around 7 to 8 steps of synthesis. Thus, there will be a constant addition to newer chemistries in the Company's overall chemical range.

Rohit Nagraj: What would be the contribution from the top customer and top products to the revenues?

Rajendra Gogri: The top 10 products are in Specialties and have contributed around 57% this year.

Rohit Nagraj: On the top customers?

Rashesh Gogri: Top customers' contribution would be around 4% to 5%.

Rohit Nagraj: Would there be any indication on the FY21 CAPEX number? This year, it is Rs. 1,200 crore, what would it be for the next year?

Rajendra Gogri: Currently, the budget is being worked out. Thus, we will come back in the Q4 results. At that time, there would be more clarity on the CAPEX.

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

Nav Bhardwaj: Could you shed some light on the raw material procurement and exports to China in the Chemical segment?

Rajendra Gogri: In the Chemical segment, there is not much of procurement from China.

Rashesh Gogri: In the Pharma segment, at least 40% to 50% of raw materials are being sourced from China.

Nav Bhardwaj: Have you witnessed any disruptions?

Rashesh Gogri: As mentioned earlier, we have been cautiously carrying a little higher inventory. That will help us mitigate the situation. If this disruption continues beyond another month or so, then we will have issues, but we will wait for two months.

Nav Bhardwaj: On the basis of all the disruptions that are going on, has there been any marked increase in number of queries? Have there been any further orders that we have got now or would it be too early to speak about it?

Rajendra Gogri: For the Chemicals' business, we have definitely seen more inquiries from the global and domestic players. That impact can be seen.

Nav Bhardwaj: Chetan, would you be able to share the current debt that is on the books?

Chetan Gandhi: The current debt would be around Rs. 2,130-2,140 crore.

Moderator: The next question is from the line of Rahul Jain from Lionrock Capital. Please go ahead.

Rahul Jain: There was a mention of three factors which have impacted the profit this year – shortage of raw material, flooding in the US and weak order demand. Considering the first factors, had there been no issues, what has that cost you in terms of profits? Any comment on that would be very helpful.

Rajendra Gogri: EBITDA could have been higher by maybe 4% to 5% .

Rahul Jain: So, the total EBITDA would have been higher by about 4% to 5% if – there was no shortage of Nitric acid and the normal weather patterns prevailed in the US?

Rajendra Gogri: Yes.

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

Rohan Gupta: On the China impact – it was mentioned that the Pharma segment can be negatively impacted as nearly 50% of the raw materials are sourced from China and that the Specialty Chemical segment will be positively impacted. If the situation continues, even if for a shorter period, then would the EBIT margins of the Pharma business go down as low as zero?

Chetan Gandhi: In the Pharma business, we have been strategically placing or keeping inventories with us. For a quarter or so, we do not see any significant impact. If it continues beyond a month over there, then we will have to see the situation, how it pans out, the available alternative source and the like. Although, I would pray that more from the business, even from the humanitarian purpose, we should pray that it does not continue beyond a level.

Rashesh Gogri: The Pharma business is split into two businesses. There is Caffeine, Theophylline, and Etofylline. No disruptions can be seen in the Xanthine business as the supply chain is largely independent of China. The other part is the specialty APIs or high-value APIs where higher stocks have proactively been maintained. That is how the Caffeine business will stay protected. It will have very less impact of the disruption because the supplies are largely independent of China.

Rohan Gupta: There was a mention that – in the next year i.e., FY21, the utilization level may remain at close to around 50% and can ramp up to 18-22%. At 50% utilization, would EBITDA be positive? What kind of an EBITDA blended margin can it contribute to in FY21?

Rajendra Gogri: Overall, it will be a positive EBITDA. The margin as a percentage will expand.

Rohan Gupta: Even at 50% utilization, the margin on the new product will be in line with the current margin of 20%?

Rajendra Gogri: Yes.

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

Surya Patra: On NCB – Nitrotoluene's volume is much lower compared to the initial run rate that was seen prior to the Nitric acid issue. Is that issue still continuing?

Rajendra Gogri: No, it has improved. In the month of January, it was virtually normal. In February, there seems to an issue as a supplier is facing a plant related issue. This quarter also, some impact of Nitric acid will be there. Inbuilt, there is enough capacity with the supplier on supply side, but unfortunately, they have been having more disruption than what you would assume on a normal circumstance.

Surya Patra: Would the Company be looking at de-risking the procurement of Nitric acid since there has been a similar situation before.

Rajendra Gogri: That is something which we cannot stock much and is now inbuilt because they have the capacity and at two different locations. This kind of a situation is not expected. On a long term basis, there should be some investment to take care of that and are evaluating that possibility.

Surya Patra: On the growth of the Pharma business – though the guidance is expected to be maintained, the recent performance has been slightly lower than the guidance growth rate. Would there be any revision of the guidance from that on the Pharma front?

Rashesh Gogri: Q3 is normally a slow quarter as compared to the earlier quarter and we expect Q4 to be better than Q3. In general, from the earlier expectation that was being anticipated, there has been a little less of the top line growth seen in the numbers, definitely. In the next year though, with the newer capacities, we are hopeful that we will have good growth.

Surya Patra: What kind of volume growth would the new capacity add?

Rashesh Gogri: The API capacities will go up by 30-40% by the addition of additional blocks. Currently, there are four blocks that are operational in the US FDA plant; the block had a 40% additional capacity. In Intermediates, there will be an addition of an additional block which will add another 15-20% capacity. The ramp-up for APIs is normally slower as compared to the ramp-up for Intermediates.

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

Naushad Chaudhary: What would be your revenue share between contractual sales and spot sales?

Rajendra Gogri: We do not bifurcate between those numbers. Generally, the business is very stable. Some of them may be from multi-year contracts, single-year contracts and other businesses that are quarterly rollover businesses. Thus, we do not have the categorized numbers.

Naushad Chaudhary: What would be the production number, for the same quarter last year (Q3 FY19), for – NCB, Hydrogenation, PDA, and Nitrotoluene?

Rajendra Gogri: For the same quarter last year, NCB was 15,800 tonnes.

Naushad Chaudhary: This would be the production number and not the sales number, right?

Rajendra Gogri: Sorry, the production number was 17,760 for Q3 FY19. Hydrogenation was 1,762, PDA was 354, and Nitrotoluene was 4,000.

Naushad Chaudhary: 4,000 for the whole quarter?

Rajendra Gogri: Yes.

Naushad Chaudhary: Against which 1,666 was for this quarter, right?

Rajendra Gogri: Yes.

Naushad Chaudhary: There is a sharp decline in Nitrotoluene, in terms of production. If you can highlight the reason for the same?

Rajendra Gogri: As mentioned, the reason is the Nitric acid shortage in various products. We expect that Nitrotoluene will get ramped-up in this quarter and then in the subsequent quarter as well if the Nitric acid remains normal.

Naushad Chaudhary: In the last quarter, we spoke about Deepak's (Deepak Nitrite) Navi Mumbai plant where there was an issue related to water supply and it was also there at an alternate source, at the Dahej plant, of the same company. These were to get resolved in last quarter. What is the situation now? Why have the issues not been resolved at the Dahej plant?

Rashesh Gogri: Deepak had a boiler outage at their Dahej plant where they produce Dilute Nitric Acid and CNA. Two of their Dilute Nitric Acid plants located in Taloja also have an outage. Out of the five of their plants in Dahej and Taloja, three of the Dilute Nitric Acid plants are not operating. This has resulted in the operation of only one / one and a half line as of today.

Naushad Chaudhary: There were expectations that their plant in Dahej would help resolve this issue.

Rashesh Gogri: Their plant in Dahej did start, but its overall stabilization is taking some time. The boiler outage that they had was not anticipated earlier. In between, their supplies were also alright, but due to the boiler outage it extended for almost over 15-20 days to a month.

Naushad Chaudhary: On the asset part of the Chemical business – subtracting the total assets of the Chemical business; looking at the consolidated number versus the standalone number – the difference would be the capital for the subsidiary companies, right?

Chetan Gandhi: Yes.

Naushad Chaudhary: There is around Rs. 70-80 crore of reduction in the total assets of subsidiaries, which used to be around Rs. 290 crore in the same quarter last year (Q3 FY19), which is now Rs. 210 crore.

Chetan Gandhi: It will have to be looked at from the perspective that – in the last financial year, one of the manufacturing divisions of the subsidiary got amalgamated. Plus, looking at the asset, considering that between the standalone and consolidated numbers, there will be elimination of translations within the Company. Thus, that gets eliminated which should not be there as part of the standalone numbers. It will not be entirely right to just do the simple subtraction, because of the elimination adjustment within the Group – which is part of consolidation and does not come in at the time of the standalone data.

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

Kishan Gupta: How much are Automotive and Agrochemicals, as a percentage of your total volume?

Rajendra Gogri: Agrochemicals is around 25-30%. Automobile is in the overall Polymer and Additive business, so, Automotive will be more towards 8-10%.

Kishan Gupta: Since we do not have the volume growth data; how is the business growth assessed?

Rajendra Gogri: It is more of value added of the total percentage.

Chetan Gandhi: Our products range from – a few rupees a kilo to a few thousand rupees a kilo in Chemical segment. Therefore, volume growth cannot be just a simple arithmetic calculation. The details for over 200 odd products of ours are looked at on a regular basis in order to track the businesses.

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

Arun Prasad: The purchase of stock-in-trade in this quarter is substantially high. Is there any specific reason for this or would it be a normal price fluctuation?

Chetan Gandhi: There were certain transactions which are related to the segment that got demerged, i.e., Home and Personal Care. The orders were placed earlier in the name of Aarti Industries and were not sold to that entity. So, roughly around Rs. 50 crore was only on account of that.

Arun Prasad: Would this recur in the next year?

Chetan Gandhi: We do not see it recurring in next year.

Arun Prasad: Can you throw some light on the Ethylation project, i.e., where it stands, the initial projection versus the current?

Rashesh Gogri: In the Ethylation project, we have been trying to ramp-up the overall utilization by offering this product to various customers. We are also looking at changing the product mix there. There has been an addition of a new product in the last quarter and in the current one. Overall, the utilization is witnessing improvement for the next year.

Arun Prasad: The current utilization must be over 60%.

Rajendra Gogri: It was lesser this quarter as this is also an Agro Intermediate. Thus, this quarter, the total utilization was only about 300 tonnes per month. Going forward, by the addition of other products, we expect the volumes to increase in FY21.

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

Rohan Gupta: What would be the breakup of the money spent from QIP as of now?

Chetan Gandhi: We raised Rs. 750 crore, utilized close to Rs. 600 crore and would have Rs. 150 crore with us.

Rohan Gupta: Could you please provide the split for the Rs. 600 crore spent, i.e., deployed in working capital and CAPEX?

Chetan Gandhi: The break-up is not available but believe that it would be close to 35% on working capital and the balance for CAPEX.

Rohan Gupta: Was the CAPEX plan for this year (FY20) of roughly Rs. 900 crore?

Chetan Gandhi: The CAPEX plan for this year was Rs. 1,200 crore.

Rohan Gupta: As of now, how much has been spent?

Chetan Gandhi: We have invested roughly around Rs. 830 crore.

Rohan Gupta: Thus, another CAPEX of Rs. 400 crore would be done in the next quarter (Q4 FY20)?

Chetan Gandhi: Yes, approximately around that number.

Rohan Gupta: Would the plan for the CAPEX of Rs. 1,200 crore remain intact?

Chetan Gandhi: Broadly, yes.

Moderator: The next question is from the line of Ankit Gor from Systematix. Please go ahead.

Ankit Gor: Due to the on-going situation in China, are there any supply chain changes adopted by the innovators/ global formulators? Apart from selecting a chain which is independent of China, any stark differences that were noticed?

Rajendra Gogri: This is going to be a long-term phenomenon. As you know, in the Chemical business, the chemistries will have to be developed and the plant/s will have to be set up. Overall, the value-added intermediates and finished products will increase from India.

Ankit Gor: Irrespective of what is happening in China would we still have seen the same trend; or would it aggravate with the trend?

Rajendra Gogri: This has aggravated because of last year's disruption. The customers thought that they could purchase from India, China or Europe but then realized that the intermediate itself was coming from China. Thus, now they want a supply chain which is totally independent of China. Previously, they were trying to source as much as possible from outside of China, although now, they are trying to ensure that the entire supply chain is also outside of China and is better if it can be independent of China. The Indian Pharmaceutical players are also in the same soup now as they also want products from within India.

Rashesh Gogri: On the Pharma front as well, customers do not want to import APIs from China because of the virus situation. They want to avoid buying Pharmaceuticals from China. It is possible that the API demand could switch to India temporarily.

Ankit Gor: In your view – is the world ready to adopt the chain that is independent of China? Are there enough capabilities with all of the countries, including India, to replace even part of it?

Rajendra Gogri: It will be challenging for the Indian companies, but would be good challenge due to the demand. There are a lot of places in Indian economy but the issue is of demand. At least in the Chemical industry, there is no issue in terms of demand as it is more about the capability to develop the product and to set up the plant. In that sense, the

Chemical industry is in a sweet spot as far as the demand is concerned. It is up to the industry players to take on the challenge.

Ankit Gor: This will probably propel the prices. Has there been any price growth / price movement witnessed in January and February as, it remained in the range of 5-10% increase only. Has the situation moved up the prices?

Rajendra Gogri: Prices change only if there are short-term disruptions. The situation on the Coronavirus now, might call for some particular product's price disruption. There is a spike sometimes with such kind of situations. Take a Company like Sadhana Nitro Chemicals and look at their last few years' profits. In 1 year, they might have made profit of 15 years. Thus, those kind of spikes have been seen and are more related to sharp shortages. In general, the margins have improved and are stable margins.

Ankit Gor: Has there been a sharp increase in any products' prices that are manufactured by the Company or would it be expected to happen?

Rajendra Gogri: Things will crystallize as mentioned earlier and by end of February, the impact on products and prices will be known. There will be price increases.

Ankit Gor: On the domestic business guidance – since 60% is domestic business for the Company, what guidance would you provide?

Rajendra Gogri: The price will increase in the domestic market also.

Ankit Gor: What sort of growth can be assumed for FY21, on the domestic side?

Rajendra Gogri: Export as a percentage will increase.

Ankit Gor: Would the domestic market remain muted?

Rajendra Gogri: Yes, the domestic growth will be relatively less next year.

Moderator: The next question is from the line of Raj Kumar from Green Portfolio. Please go ahead.

Raj Kumar: When can we expect the listing of Aarti Surfactants?

Rajendra Gogri: It will happen either happen at the end of this month or maybe in March.

Raj Kumar: Could you explain the revenue and profit target for FY20?

Rajendra Gogri: It has been mentioned that we are maintaining the guidance of a 10-15% increase in the bottom line.

Raj Kumar: In the Coronavirus situation – would we have a proper vendor substitute / input substitute available, in the case that if anything happens, there is still as opportunity?

Rajendra Gogri: For the Chemical business, we have a plant in which certain type of products can be made. It is not a 'made-to-order' kind of facility. Thus, within our own product mix if the opportunity arises, we will get the benefit as it would not be a new product. With new products, they need to be developed with environment permission and the like that will be required as well.

Raj Kumar: Would the Coronavirus be an opportunity for the Aarti Industries?

Rajendra Gogri: Yes.

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

Rajendra Gogri: Overall, we remain confident that our diversified exposure to chemistry, products, clients, geographies and low-cost sustainable and regulatory compliance operations, provide the platform for – long-term partner-of-choice relationships, market share gains in global supply chains and substitute import in domestic manufacturing ecosystem. It has been a pleasure interacting with you over the call. We thank you for taking the time out and engaging with us today. We have your continued interest and support; we value it. If you have any further questions or would like to know more about the company, kindly reach our investor relations desk. Thank you.

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