Aarti Industries Limited

Q4 FY22 Earnings Conference Call

May 30, 2022

Moderator: Ladies and gentlemen, good day and welcome to the Aarti Industries Limited Q4 FY22 E2arnings Conference Call. As a reminder, all participant lines will be in the listen only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference, please signal an operator by pressing "*", then "0" on your touch tone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Nishid Solanki from CDR India. Thank you and over to you, sir.

Nishid Solanki: Thank you. Good evening, everyone and thank you for joining us on Aarti Industries Q4 & FY22 earnings Conference Call. Today, we are joined by senior members of the management team, including Mr. Rajendra Gogri, Chairman and Managing Director of the company; Mr. Rashesh Gogri, Vice Chairman and Managing Director; and Mr. Chetan Gandhi, Chief Financial Officer. We will commence the call with opening thoughts from Mr. Rajendra Gogri, who would take us through the performance, key milestones achieved and outlook on the business. Post this, we shall open the forum for question and answer where the management will be addressing to the queries of the participants. Just to share our standard disclaimer here, some statements that may be made in today's call may be forward looking in nature and the disclaimer to this effect has been included in the results presentation that has been shared earlier and also uploaded on stock exchange website. I would now invite Mr. Rajendra Gogri to share his perspectives. Thank you and over to you, sir.

Rajendra Gogri: Thank you, good evening, everyone and welcome to our Q4 & FY22 earnings conference call. We have shared our results documents and I trust you had an opportunity to go through them.

Financial Year 2022 was highly unpredictable and a challenging period for everyone. What started with a resurgent second wave of COVID-19 pandemic, turned into a significant inflationary surge in inputs prices, and then the Russia-Ukraine conflict which disrupted the global supply-chain and resulted in elevated prices of crude oil, other petrochemical intermediates and other fuels such as coal, etc. Given this backdrop, I am elated to share that we demonstrated agility and navigated through these pressures to deliver robust financial performance during the period under review. We scaled new peaks backed by our high-quality business enterprise that has been built over several decades with solid execution capabilities.

Let me share some of the key numbers for FY22. Our revenues increased by 58% to Rs. 7,919 crore, while EBITDA came in at Rs. 1,930 crore, higher by 96%. Profit after tax stood at Rs. 1,307, higher by 144% over last year. FY22 financials includes an impact of termination fees received with respect to the first long-term contract to the tune of Rs. 631 crore. Excluding termination fees, our annual revenues were at Rs. 7,288 crore, while EBITDA was at Rs. 1,320 crore. We achieved the highest-ever EBITDA in the Company's history in FY22 even after netting off the impact from termination income. Normalising the termination income for FY22, the EBITDA growth for FY22 was about 35% over FY21.

In Q4 FY22, we registered 50% gains in revenues to Rs. 2,018 crore, driven by better realisation trends owing to our ability to pass on sharp spikes in RM costs and other utilities. This was supported by healthy volume uptick during the quarter led by continued demand outlook for our products in the key end-user industries. EBITDA enhanced by 30% to Rs. 339 crore, while EBITDA margin stood at 16.8%. Having said that, we were able to maintain the absolute delta margin despite cost pressures in the system. Further normalising the impact of the shortfall fees of Rs 37 crs for Q4FY21, we recorded about 52% Y-O-Y growth in EBITDA for Q4FY22. Also when compared with Q3FY22, which included the Shortfall fees of Rs 47 crs, the QoQ EBITDA growth (net of termination income & shortfall fees) was about 11% for Q4FY22. Also, the commissioning of a few projects resulted in an increase in depreciation and Fixed overheads during Q4FY22. Our profit after tax enhanced by 39% to Rs. 194 crore, in-line with the operational performance. Premised on healthy performance during the year, the Board of Directors approved a final dividend of Rs. 1.50 per share for FY22. This is in addition to an interim dividend of Rs. 2.00 per share distributed during the year. With this, the total dividend in FY22 stands at Rs. 3.50 per share i.e., 70% of the face value. During Q4 FY22, we witnessed significant volatility in the prices of key inputs largely due to various issues including the one pertaining to Russia-Ukraine conflict. We wish to clarify that while we don't have any significant business in the region and hence see no significant impact of the same on our business.

Moving to the segmental performance overview. Revenue from Speciality Chemicals business in Q4 FY22 increased by 49% to Rs. 1,629 crore, while EBIT expanded by 19% to Rs. 246 crore. However, as highlighted, we were able to pass on these variations to our customer in a structured manner. More importantly, our ability to suitably optimise the product mix helps sustain the overall volumes. Having said that, we are closely monitoring these developments and will take appropriate steps as and when required.

I will now share the production details for Q4 of FY22. Production of Nitrochlorobenzene was about 19551 MT compared to 19,100 MT in the corresponding period of last year, and close to 18,504 MT for Q3 FY22. Likewise, for hydrogenated products, we attained a production run-rate of 3029 MT compared to 1,935 MT last year, and 2,878 MT in Q3 of FY22. For Nitro-Toluene, the production for Q4 FY22 stood at 5155 MT, compared to 2,935 MT in Q4 of last year, and 3,633 MT in Q3 FY22. The quarter went by saw some production and revenue impact due to supply shortage of key raw material 'Nitric Acid', as indicated in the previous call. We have been closely working with the supplier to minimise the impact and optimise the product mix to protect the profitability. We continue to be engaged with the supplier to find alternatives to improve the situation, which has a significant bearing on our performances.

Turning your attention to projects commissioned during the quarter. We began commercial manufacturing in respect of the project related to the 2nd Long Term Contract in Q4 FY22. This will add incremental revenues to the tune of over Rs 500 crs by end of FY23. Other major projects such as Project linked to the 3rd Long Term Contract at Jhagadia, the NCB capacity expansion at Vapi, etc are expected to come on stream in FY23 and will see ramp up over FY23 and FY24.

Further with respect to the unit wrt to the 1st Long term contract, we had seen some volumes in FY22 and expect a progressive ramp up of the same over next two years, targeting the utilisation to be about 70%-80% by FY24. I believe that we are well poised to capture incremental market opportunity in the specialty chemicals space based on our leadership position and expertise in the chosen chemistries. This including healthy demand in both domestic and export markets combined with capacity expansion initiatives will elevate our performance momentum in the ensuing years.

Now, shifting your focus to the Pharma business. We reported 52% revenue growth to Rs. 388 crore in Q4 of FY22. EBIT came in at Rs. 67 crore, higher by 30% Y-o-Y. In line with the overall operations, we were able to pass on part of spikes in raw material costs and other utilities in this segment as well, resulting in better realisations. We demonstrated strong volume growth backed by continued positive demand landscape and higher off take from generic pharma companies and Xanthine businesses. Business visibility continues to be high, and we are very well placed to realise the growth potential in this segment based on our strong product line-up, timely introduction of newer products and attractive pipeline of approvals in cardiovascular, anti-hypertensive, oncology and corticosteroids.

With respect to expansion of the new block at the USFDA approved API facility at Tarapur, we are in the final stages of the commissioning, and expect this to be commercialised in the current year i.e., Q1 of FY23.

Moving on, as you are aware, we had witnessed significant inflationary trends in the input costs, logistics cost, fuel costs, commodity prices, etc over FY22. For instance for various of the key RMs, and inputs, the prices had gone by about 50% to 100%. It may be noted that while a significant part of this price increase is passed on to customers, there is a working capital cycle gap for the same to get converted to cash, which enhances the company's resources getting deployed in working capital. We are closely examining the same and taking efforts, where possible, to reduce it.

Overall, we entailed a CAPEX of over Rs. 1,300 crore in FY22, with about Rs. 360 crore spent in Q4 FY22. This was in-line with our planned CAPEX outlay for the year. As you are aware, over the years, we had invested into various projects, of which few had been commercialised during the last 12-15 months. The ramp-up of these projects had been impacted due to the challenges faced due to the pandemic, availability of key raw materials and also partly due to the cancellation of the long term contract. We are now witnessing a good ramp-up of these capacities and expect most of these to see its capacities reach about 70% - 90% utilisation by FY24. Going forward, we remain committed to investing Rs. 3,000 crore+ by FY24 to achieve our growth aspirations. Our focus will be to undertake R&D and innovation-led projects where we have 40+ products for Speciality Chemicals and 50+ products for Pharma in the pipeline. This will lend visibility and help achieve our growth guidance for FY27, as shared earlier. To manage and execute this, we have also onboarded close to 1,500 personnel in FY22 across various functions.

Before I conclude, let me share a couple of important developments.

- As you are aware, we had been witnessing shortages at multiple times for availability of the one of the key RM, ie CNA. This had a significant impact on our operations. In order to mitigate this risk, we propose to set up a backward integrated unit for Concentrating Nitric Acid from dilute Nitric Acid with a capacity of about 225-250 tpd to partially meet our requirements. The feedstock for this is expected to be sourced from India or from global markets. We had tied up with a technology partner for the same and expect the facility to be commercialised by the end of FY24. This will assist in easing off of our challenges with reference to the sourcing of Nitric acid in future.

- During FY22, Aarti Industries was awarded the prestigious Responsible Care status by Indian Chemical Council (ICC). Responsible Care is a global initiative to drive continuous improvement in safe chemicals management and achieve excellence in Environmental, Health, Safety and Security (EHS&S) performance
- Further with reference to our ongoing process for demerger of Pharma business into Aarti Pharmalabs Ltd, we wish to appraise that the NCLT, Ahmedabad has scheduled the hearing on our application in June 2022. We are hopeful to get the favourable approval from NCLT in the aforesaid hearing. Subsequently it would take two to three months for completing the formalities related to demerger, allotment of new shares by Aarti Pharmalabs Ltd and listing of those on the respective exchanges.

As you are aware, India is at a very sweet spot and the road ahead appears encouraging. We are excited to lead India in its aspiration of becoming a preferred partner for global chemical majors. Our focus on value-addition and product expansion will steer the momentum in the ensuing years. This will further cement our leadership position, while enhancing value for all the stakeholders. With these rationales and the stronger visibility available, we are better placed to meet the guidance for FY24 and FY27 as shared last year.

That concludes my initial thoughts and will now request the moderator to open the floor for the Q&A session. Thank you.

Moderator: Thank you, ladies and gentlemen, we will now begin the Q&A session. We have the first question from the line of Umesh Patel from Reliance Nippon Life. Please go ahead.

Umesh Patel: Thanks for the opportunity, congratulations Rajendra bhai for reporting good numbers. Couple of questions – as you mentioned about backward integration, I just need to understand that 250 TBD that you mentioned that is transferred into 60,000 metric ton per annum for nitric acid, what would be the CapEx that will be incurred?

Rajendra Gogri: This will be basically a concentration plant from a weak nitric acid to concentrated nitric acid and we are overall, you know, evaluating the entire nitric acid scenario. By Q1, we will be able to guide on the CapEx front on this, but around this plant itself. Cost will be around INR 150-200 crore range.

Umesh Patel: Sure, So that will take care of the entire requirement of your nitric acid or it will be something like 50 to 60% of your requirement?

Rajendra Gogri: No, actually this will be more of a balancing – where we cannot get nitric acid from the market, we can buy weak nitric acid and concentrate it to concentrate nitric acid. This weak nitric acid also can be imported from outside India, whereas concentrated nitric acid cannot be imported into India. That was one of the reasons why we are putting up this facility so that importing the weak nitric acid and then converting to the concentrated nitric acid will become feasible.

Umesh Patel: On the pharma segment that you mentioned about - API facility that will, you know, get the approval from US FDA and that is in the final stage. What would be the revenue potential of this facility and what would be the EBITDA margin that will contribute to your Company?

Rashesh Gogri: The new facility is going to come on stream from the current quarter. It will be a ramp up in the next three years and we will be able to utilize the total potential. The total revenue potential is $25-30 million and EBITDA will be line with our EBITDA margin of 17-20%.

Umesh Patel: If you look at China recently, if I recollect properly in 2019 when there was an issue in China, it helped us in, reporting very good set of numbers in terms of profitability. So again, in this quarter also April to June there was a supply disruption and China lock down that happened. So do we expect that again, the similar kind of situation will arise for Aarti Industries being, market leader in most of the Toluene based as well as nitrogen based derivative products?

Rajendra Gogri: No, currently we are not seeing any significant impact of the lockdowns in China. The material going into China is a bigger problem than material coming out of China, in general.

Moderator: Thank you. We have the next question from the line of Surya Patra from Philip Capital, please go ahead.

Surya Patra: Congratulations for the good set of numbers. On the margin front, if adjusted for the termination fees or the compensation what we had received in the corresponding previous quarter, our margin almost remains flat, despite of the elevated cost in terms of logistics, utilities and all that. I believe that the pass on of the elevated RM cost is possible, but may not be the case for utilities and all. How did you manage that margin remaining same or what has contributed incrementally otherwise?

Rajendra Gogri: Generally logistic costs get transferred because the ocean freight has increased so much, it becomes difficult for us to bear the ocean freight change.

Surya Patra: Utilities?

Rajendra Gogri: Utility sometimes, you know, becomes difficult, but I think utility was already high. So on a QoQ basis there is not much change in utility cost.

Surya Patra: Now having seen whatever kind of cost situation now and it seems that the elevated cost situation is likely to prevail mostly possibly entire of this year, FY23. So given that, could you give some sense on your cost line items? So, because you are also indicating that you have added some 1,500 odd people in FY22 possibly throughout the year that you would have added so the incremental cost will be added because of that, so what is the kind of change that we should be seeing in terms of the cost with it? Can we maintain or see some improvement in the gross margin front, having seen the peak of RM cost scenario currently?

Rajendra Gogri: Yes, actually this number of people which has been added is also for, whatever was commissioned in the second contract, as well as some of the people have been onboarded for the , start of this third contract and some of the other projectswhich are going to get lined up. They will be utilized mainly for the newer facilities andcorresponding expenses will be absorbed in the volumes generated out of it.

Surya Patra: You do not guide on the margin front but given the kind of absolute cost expansion what is visible, do you think your absolute EBITDA growth will be in line with the earlier guided trend?

Rajendra Gogri: Yes, overall, because correspondingly there will be a volume increase also. At the EBITDA level,we feel whatever the guidance which we have given on FY24, we should be able to reach those level in next year.

Surya Patra: In terms of the people, with this addition of 1,500 what is the total?

Chetan Gandhi: It will be roughly around 8,000-8,500 in employee workforce.

Surya Patra: About the second contract that you have commissioned. Given the challenging situation that is prevailing, do you think it will be a very staggered one than the earlier expectation, versus the INR 500 crore kind of run rate, are we going to start the year with, let us say 50% utilization of that optic program or some sense will be?

Rajendra Gogri: No, it will be at a very high level of percentage utilization from the first year itself, the way the contract has been structured. So there will be a significantly high percentage utilized.

Surya Patra: Since it is the plastic oriented, given the weakness that is visible in the global economy process, would there be a kind of moderation in the volume expectations out of that?

Rajendra Gogri: No, overall not, we have that contract structure we do not see much issues there.

Moderator: Thank you. We have the next question from the line of Aditya Khetan from SMIFS Limited. Please go ahead.

Aditya Khetan: My first question is on the API capacity expansion. If you can highlight the absolute capacity figure in liters and how much in terms of percentage also if the capacity is increased to, how much would be that in terms of percentage increase?

Rashesh Gogri: The API capacity, basically we are putting a high-volume line and the products which we will be manufacturing there will be $200 to $500 of kg product. So what we are doing is from the current line, we are moving the high volume products to the dedicated lines. We will have very high occupancy overall because of that, because we already are having significant occupancy of these in our current multipurpose lines. We have now graduated to a level where the production shift to dedicated lines.

Aditya Khetan: This figure of $200 to $500 per kg, would this be done from the increased capacity?

Rashesh Gogri: Mix of existing products and mix of new products. Largely the volume will be built by existing products and one or two higher new products for which, you know, we have already done the validation and other things. The products are now getting launched or mature.

Aditya Khetan: From the raw material aspect in terms of China, there are some raw materials which are imported from China, there is a disconnect in domestic prices and

China's prices. Because of this we are witnessing that imports have started to increase and China is offering them at a much lower price as compared to the domestic players. On account of the lockdown and all, so there is a disconnect in many of the raw material prices. Are you witnessing that for the next quarter, there could be some sort of impact from this China related shift, if suppose they are offering at a lower price, so volumes can be shifted toward China?

Rashesh Gogri: Are you asking pertaining to pharma, chemicals or both?

Aditya Khetan: Sir, for chemicals specifically.

Rajendra Gogri: No, for chemical basically we are totally backward integrated and we do not see any movement, any shifting towards China for our product line.

Aditya Khetan: But in terms of pricing, there is a disconnect for the raw materials, is this data point, correct?

Rajendra Gogri: No, it may be for some specific products, but overall we are not seeing any significant impact.

Aditya Khetan: On the revenues – for this fiscal, we have clocked roughly 42% revenue growth, this is excluding the termination income, so how much of this would be from the volume and realization, just a ballpark figure would do, sir?

Chetan Gandhi: You're talking in terms of the annual volume growth or what?

Aditya Khaitan: Annual volume growth.

Chetan Gandhi: That would be in the range of 18-20% plus.

Aditya Khaitan: Okay, 18%-20% is the volume growth for FY 22?

Chetan Gandhi: Yes.

Rajendra Gogri: On your question on volume growth – the first contract because it got canceled, we already got the assets online and those assets we had just started the production in that plant and as I mentioned in our speech by FY24, we will have 70-80% capacity utilization for that product and actually that is a value added product of four steps, corresponding, backward impact of the entire value chain volumes that will come in. The second contract has been commissioned in Q4, so that volume will come in and this yea; partly nitric acid also had impacted. Once the nitric acid stabilizes, we expect 70-90% capacity utilization by FY24 for most of our plant.

Aditya Khetan: On nitric acid – when I was looking at your number for the last 7-8 years, nitric acid contribution in the overall raw materials is only about 7-8%. So considering if there is a shortage also, so does it impact us much on the cost that is what I wanted to know.

Rajendra Gogri: Yes, because nitric acid you are going to see raw material. So, price is one factor, the availability is a bigger factor. If you have less material available, but overall we see that nitric acid situation will improve because in second half of this year some new nitric acid capacity will come up in India. So we feel that availability front is out in FY23.

Aditya Khetan: On this INR 2,500-3000 crore of CapEx for the specialty chemical which we are doing from FY22-24, if you can give some rough break up on this, INR 3000 crore revenue of CapEx onto the specialty chemical.

Rajendra Gogri: For the existing activity in our running business, what we had guided was in around INR 1,500 crore and the rest will come up for the new product, which the sales will start coming more in FY25 onwards, that'll be a multipurpose plant.

Aditya Khetan: So this INR 3000 crore of CapEx for specialty chemicals, so I believe one part is for the chlorotoluene and second is for the universal multipurpose?

Rajendra Gogri: Yes and some of the existing product downstream also, we will be expanding capacities in addition to the entire new range of products.

Aditya Khetan: In terms of number if you could give?

Rajendra Gogri: I think that we will have to work out and then come out in maybe next few quarters, the detailed breakup of this campaign.

Moderator: Thank you. We have the next question from the line of Ritesh Gupta from Morgan Stanley. Please go ahead.

Ritesh Gupta: Just wanted to understand a couple of things. If you just look at the last two quarters' commentary, you talked about nitric acid challenges and logistics cost, etc. had also gone up, going forward the challenge also lies in terms of probably the US recession, etc. If I sum up all the one offs in last 6 months and then I see the head winds in the next 6 months, what looks better? I mean, the kind of margin that we saw in last 6 months or probably next 6 months, again, energy costs, etc. also been higher, or probably the running quarter energy cost etc. also on the higher side. From the second half, as we go to the first half this year, should we see momentum improving or should we see similar sort of challenges sustaining in the first half?

Rajendra Gogri: Yes, basically overall the discretionary side demand has some impact, but we are able to rearrange our product mix and agrochemical side the demand is quite strong, I think because agri commodity price are also strong. Overall, we see, as far as volume possibility, there is not much issue and nitric acid this year in the first half may still remain challenging; maybe second half the capacity in India will increase. This will stabilize the availability.

Ritesh Gupta: If I just extrapolate your guidance of EBITDA doubling over FY21 and FY24, you are looking at 20% growth over next 2 years in terms of EBITDA. Given that, even when I look at your FY22 commentary you said that, lack of operating leverage, higher fuel and power costs and logistics cost, etc., do you think that there could be a potential upgrade to the FY24 numbers or is it that you want to conservatively stick to it or is there some sort of upside which is there, which let us say FY21 all your Bayer contract and the contract 1, contract 2, contract 3, all start operating and plus some of the capacity expansions that you have seen and the kind of discretionary demand issues that you have seen in the last year normalized or is there something else which I need to keep in mind when I see your guidance of doubling of EBITDA up to FY24?

Rajendra Gogri: Yes. I think more or less we can still maintain the EBITDA guidance overall. I think 1.7 to 2 times what we have guided for FY24. I think those are the kind of number we should be able to hit.

Ritesh Gupta: No, sir, the question is that when I look at the lower end of the guidance, when I look at 1.7 number, you already moved to 1.34 this year. When I look at the lower end of it, we are talking about 35% improvement on a base of 1320, so you are talking about like a total of 25-27% EBITDA growth over next 2 years combined.

Rajendra Gogri: Yes, but this year, you know, there was INR 138 crore shortfall fee, which is part of EBITDA of this year.

Ritesh Gupta: Right Yes.

Rajendra Gogri: So that gets knocked off in FY23 and FY24.

Moderator: Thank you. We have the next question from the line of Abhijit Akella, from Kotak Securities, please go ahead.

Abhijit Akella: For FY22, you know, you had guided to 25-35% growth and of course you have exceeded those numbers. Is there a rough number you could sort of guide us to for FY23 as well on revenue and EBITDA growth?

Rajendra Gogri: No, overall as I just mentioned, you know, this FY22, we had about INR 138 crore shortfall fee for our first contract, which was mainly accounted in first three quarters, which will not be available going forward in the next year. We have a volume ramp up for a lot of projects. So this will be more of a consolidation and we see high single digit growth in EBITDA in FY23.

Abhijit Akella: High single digit growth in EBIDA and on revenue should we expect a similar kind of growth rate as well, high single digit?

Rajendra Gogri: Revenue growth may be higher because that's shortfall fee was without any revenue, revenue growth will be more.

Abhijit Akella: Understood, sir, that is helpful, just on the situation in the export markets, particularly Europe, you know, where I mean, there has been talk of, you know, significant impact to the economy because of gas costs and everything, if you could please just help us understand what the situation is like there in terms of our key customers or end use industries and whether you are seeing any softness and if that impact business in the year ahead?

Rajendra Gogri: Actually, because we make value added intermediates and then subsequent value addition whatever is done in, the requirement of energy in that valuation will be limited. Actually energy requirement in our range of product is more, we see that, some of the products where we compete with Europeans, there may be some issues whereas our customer side. We do not see much issue on demand front.

And the European companies, most of our customers, they make the product for global market. It is not for a European market. The way chemical industry is structured is that we may supply something to North America, Europe, but the product what they make there that is for a global market.

Abhijit Akella: On the nitric acid project, if you could just share some information about what our total requirement is on an annual basis and how much of that will be catered to by this expansion that is coming up.

Rajendra Gogri: Yes, this will be more of a backup kind of an arrangement, if CNA is not available, we can import weak nitric acid from overseas also and convert it into concentrated nitric acid. This will be more of a kind of a backup arrangement. We are yet to work out the overall comprehensive nitric strategy, that is still in development, what should be our long term strategy on nitric acid.

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

Rohit Sinha: On the employee cost – as you have mentioned that you added 1,500 employees. They have probably been added in the second half of FY22 and since second contract was executed, most of that was maybe dedicated to that type. Just wanted to understand that at which level is this large number being employed. With probably the third contract coming up and obviously other projects getting commissioning, do we see another addition on these numbers?

Rajendra Gogri: Yes, this number 1,500 was for throughout the year, for the projects which were commissioned and also the projects which are going to get commissioned over this third contract and some other intermediate plant, which will be mostly commissioned in the first half of FY23. So we are already onboarded the people for the plant, which are going to be commissioned mainly in this first half of FY23. You see, overall now there is a talent pool in the chemical market because a lot of investments are coming up by a lot of companies and one of the key challenges going forward will be how do you manage the talent? So that is why, we like to have some cushion in the talent and also do continuous internal training to upgrade the people. We are coming up with very large expansion, it is very important that human resources are properly taken care of.

Moderator: We have the next question from the line of Archit Joshi from Dolat Capital. Please go ahead.

Archit Joshi: Congratulations on the good set of numbers. In terms of the presentation and from your introductory remarks, you had mentioned that there are about 40 odd products in the speciality chemicals division that we are targeting to introduce, I would like to understand if there is any particular chemistry that we are focusing on or if you can just throw some light on what kind of products will these be that might be coming in the next 2-3 years, will it be application specific or chemistry specific? If you can also mention the rationale as to why we are introducing them.

Rajendra Gogri: Yes. Basically one big range will be entire chlorotoluene range and the chemistry what will come is first will be what we call ring chlorination, which is different than what GSTL has announced, they have announced which is called sidechain chlorination. So first will be ring chlorination, which is similar to what we do for benzene and there will be a new chemistry, first time will be, you know, photo chlorination then, chlorine as in using anhydrous hydrofluoride acid, then ammoxidation, Grignard reaction, chlorination. These are the kind of chemistries which will be there and this again is an integrated chain and most of the product in this will be going mainly in pharm, agro and dyes and pigments, that will be the major outlet for this product range and the main driver here is, again, there will be import substitution, as well as global customer wanting to shift some of the demand from China to India, that is a major driver in this entire chain.

Archit Joshi: In the earlier chemistry that we were into, we had sort of a dynamic model that we had adopted from aminolysis, nitration or chlorination and this is a completely different basket of chemistry that you are speaking about right now. How different would it be from our existing business model of manufacturing those five chemistries in which we were in top three, maybe top four globally. How will we be placing ourselves, will this be again through having dedicated plants for certain chemistries, because you are also speaking about setting up a universal multipurpose plant and these chemistries are completely new to what we were doing in our existing business model.

Rajendra Gogri: Photo chlorination and all, what we call it will be single chemistry multi-product plant, so we will be running on campaign, different photo chlorination products or anhydrous hydrofluoric, AHF fluorination, this will be dedicated chemistry with multiproduct line, ammoxidation will be also totally dedicated multi, so there is dedicated chemistry multi-product, and there will be this multipurpose where we will be able to do multi chemistries, where we can do Grignard and all other ammoxidation and all those chemistries that are more advanced chemistry generally and typically are then done in multipurpose plants. We also have those kind of complex chemistries in our existing business, but they are like diazotization and all, but most of our plant up until now were dedicated to those chemistries and now we know we will have more of an additional multipurpose kind of a facility on ground.

Archit Joshi: In some of the previous calls you had already mentioned about the kind of market from the import substitution angle for chlorotoluene and if you can similarly also speak about this new chain that we are targeting in photo chlorination, what kind of applications and what kind of size we might be targeting and if you can just speak also on the competitive analysis of this one, thank you.

Rajendra Gogri: This photo chlorination is part of chlorotoluene chain itself. We will be this ortho chlorotoluene and para-chlorotoluene, photo chlorination done, but there, you know, we can also do direct toluene photo chlorination, which is also being done by -- which GSTL also is planning, so those kind of products also can be done because this will be a dedicated to the chemistry where we can move the product around.

Archit Joshi: This being a part of chlorotoluene itself, would there be any difference on the chemistry side or is this just like a whole, if you can say, simply speaking would photo chlorination will be subset of chlorotoluene?

Rajendra Gogri: No, you see, like PNCB was other, nitrochlorobenzene and all, we do first chemistry, then some product will go to the second, third, fourth, fifth chemistry.

Archit Joshi: Understood, got it.

Rajendra Gogri: Photo chlorination is the second chemistry after flourine chlorination.

Archit Joshi: Okay, so basically this will be quite similar to our existing model.

Rajendra Gogri: Yes, it is very similar and is a very robust model what we see, because that we have done for two benzene and nitrotoluene.

Archit Joshi: Got it, sir, thanks a lot, sir. That's it from my side.

Moderator: Thank you. We have the next question from the line of Rohit Sinha from Sunidhi Securities, please go ahead.

Rohit Sinha: As we were talking about the employee aspect, I was looking at the competition right now in this chemical segment has quite intensified and this talent hunt and retaining the talent has been a challenge as of now and maybe going forward it could be more like that. I do not know whether you commented on that part since my line got disconnected; if you can touch upon that point also?

Rajendra Gogri: Yes, I mentioned that overall, because a lot of investments are coming in chemical and specialty chemicals and there is obviously a talent shortage, which is expected going forward. Our idea will be always to be one-up on our manpower requirement and also do a lot of internal training because howsoever you may do, there will be some turnover which may happen. We have a dual strategy, one is to keep robust internal pipeline ready and also try to be proactive in filling the requirement at least 5-6 months in advance.

Rohit Sinha: On R&D – how much has been our total spend for the segment in FY22 and how is it being planned with this R&D going forward, with a lot of new chemistries that are coming up. The kind of investment would be a bit on the higher side on this R&D, or would it be in line with what we have in there and if at all we have also onboarded some of the maybe scientists or research personnels.

Rajendra Gogri: We already also onboarded lot of people in R&D also. The R&D spend will be around in the INR 60-80 crore range and may go further up little bit in next 1 or 2 years.

Moderator: Thank you. We have the next question from the line of Rohit Nagraj from Emkay Global. Please go ahead.

Rohit Nagraj: Congratulations on the good set of numbers. We have completed 2 months of the current quarter, so from the demand side or the logistics and war issues, have we faced any challenges in terms of deferment of orders or any cancellation of orders? Thank you.

Rajendra Gogri: Yes, we missed the word, you are talking about Russia-Ukraine war?

Rohit Nagraj: Right, that is one part plus the logistic challenges and the increase in raw material because crude has gone up and subsequently benzene and toluene has also gone up.

Rajendra Gogri: Overall, these have not impacted much on the demand side, because of the impact of us increasing this cost in the finished product is not very high, but in general overall inflation increasing is seeing some pushback in demand on dyes and pigment side in general, that is with the broader inflation, which is kind of some of the discretionary spends. We are seeing some pushback coming in, but the agro side is more robust for us and then we are continuously trying to reshuffle our product mix as well as the geographical mix to have high capacity utilization.

Rohit Nagraj: For the second long term contract, I understand that we were supposed to get the CapEx upfront from the customer, I think, close to about INR 400-450 crore, so we have commissioned the project last quarter. So have we received that particular amount, which will probably get adjusted in incremental invoices?

Rajendra Gogri: Yes, I think we have received almost 80%.

Rohit Nagraj: You also mentioned that we have added a significant amount of employees during last year. So Q4 is the base employee cost run rate that will continue given that incremental additions will be relatively limited as we have sufficient bench probably created?

Rajendra Gogri: No, because Q4 some of the employees for contract three and all, their cost right now will go in your capital WIP. So there some number will and employee cost will increase in next year, but substantial portion has come as a revenue expenditure in Q4.

Rohit Nagraj: On the guidance of high EBITDA increase, so on a basis of FY22 base of organic EBITDA excluding the INR 138 crore plus the INR 630 crore termination fee?

Rajendra Gogri: No, termination fee is obviously excluded, but the INR 138 crore shortfall fee will be considered part of that FY22.

Rohit Nagraj: On that high single digit is what we are looking at.

Rajendra Gogri: Yes, that is what we are looking at.

Rohit Nagraj: Thank you so much for all the clarifications and best of luck, sir. Thank you.

Moderator: Thank you. We have the next question from the line of Siddharth Gadekar from Equirus. Please go ahead.

Siddharth Gadekar: I just had one, first question was pertaining to the capacity utilization. Now, if you look at your gross block over FY19-22, we have added roughly INR 3000 crore of gross block, out of which I think INR 500 crore would be for that Bayer contract, which got terminated, so over FY19-22, how has our capacity utilization moved?

Rajendra Gogri: Yes, it will be on always on product, nitro toluene we have reached almost 80% capacity in Q4, so individual process block wise, the capacity utilization will be different, so that we are saying by FY24, virtually all the blocks will reach 70-90% of capacity.

Siddharth Gadekar: That is what is capitalized FY22? Is that understanding right?

Rajendra Gogri: No. What will be capitalized in FY23 also.

Siddharth Gadekar: Okay, so by FY24, we will be in the range of 70-80% capacity utilization.

Rajendra Gogri: Yes.

Siddharth Gadekar: In terms of volume growth over FY19-22 how have our volumes grown; a ballpark number also will do?

Chetan Gandhi: We will have to work on that; It will not be very simple to give that number right now.

Siddharth Gadekar: Okay, sir, thank you.

Moderator: Thank you. We have the next question from the line of Ranjit from my IIFL Securities. Please go ahead.

Ranjit: Thanks for this opportunity, the first thing, you have said a different chemistry reaction that you intend to take in future, would you able to give some idea on the realization, maybe a ballpark or an EBITDA on a ballpark thing. The idea is to understand whether these are going to be structurally different from what we have been doing till now. Thank you.

Rajendra Gogri: Yes, basically this will be more value added products. EBITDA to sales definitely the constant raw material prices will be higher in this range of products, because the value added composition will be significantly higher in that and being a more advanced chemistry also tend to give a higher EBITDA to asset.

Ranjit: Just to put the number to it, would it be safe to assume that it would be at least 30-40% higher than what we are doing currently?

Rajendra Gogri: Yes, generally, you know, if it is 20%, then at the similar level, it will become more to 25%, for the incremental kind of range of products.

Moderator: We will move to the next question. Mr. SA Narayan from Capricorn Research?

SA Narayan: Yes, Mr. Gogri, on the new chemistry, could you please tell us what are the user industries involved, which kind of sectors would you be addressing?

Rajendra Gogri: It will basically mainly be in pharma, agro and dyes and pigment. Pharma and agro will be more or less, maybe 70-80% and maybe 20% will be other sectors.

SA Narayan: All right, and these would be growing volume?

Rajendra Gogri: Oh yes, the molecules which are there in this both for pharma and agro, pharma will lead to a lot of import substitution and agro molecules are growing molecules.

SA Narayan: Very good, thank you very much.

Moderator: Thank you. We have the next question from the line of Meet Vora from Axis Capital. Please go ahead.

Meet Vora: On nitric acid -wanted to understand the cost dynamics between importing dilutive nitric acid and then concentrating it versus if we are directly procuring concentrated nitric acid from India and at the same time, since we are having nitric acid as a key raw material for majority of our products, why do we not set up a plant for manufacturing nitric acid itself rather than setting up a plant for concentrating it from the diluted nitric acid?

Rajendra Gogri: As I mentioned, you know, we are in process of developing the comprehensive strategy for, you know, both ammonia to weak nitric acid, as well as weak nitric acid to concentrated nitric acid. The first phase now, immediately, we have decided to go ahead with but there are two separate parts in a nitric acid plant, they are two separate plants, one is to make weak nitric acid. Many fertilizer companies make weak nitric acid and use it for fertilizer and some of the companies they make concentrated nitric acid, so they are two different parts. So at the first phase, you know what we have decided is to immediately go ahead putting up a concentrated nitric acid from weak nitric acid, and which can be imported also, this will be more on your availability mitigation, but the longer term comprehensive strategy is being worked out, which we should be able to clarify maybe by Q1.

Meet Vora: Sure, sir, and the concentration part that we will be doing right now, our plan is to import that entire dilute nitric acid, or we will be procuring it locally?

Rajendra Gogri: No, it can be procured locally also, but that is at least one raw material which can be imported, whereas concentrated nitric acid in principle cannot be imported and that kind of really restricts. Here we can import, so that availability will not be a problem. My price may be INR 5-10 higher, but know the multiplier effect for us is much more if the material is not available.

Meet Vora: Sure, sir, understood, sir, that is a good step, thank you.

Moderator: Thank you. We have the next question from the line of Aditya Khetan from SMIFS Limited, please go ahead.

Aditya Khetan: On volumes – I missed your initial commentary, if you can share the volume for nitrotoluene, NCB and PDA business?

Chetan Gandhi: So for the nitro-toluene we had the volumes of around 5,155 tons for the quarter, PDA we were at roughly around 527 tons a month and NCB we were at 19,550.

Aditya Khetan: So when we look for the last 3 years in terms of your CapEx, so roughly we had done from FY19-22 some sort of 27% - considerably on the EBITDA side, we are witnessing only 11% growth and the revenue there is only 15% growth. It seems that the CapEx what we have done for the last 3 years have not yet flowed into your top line and consequently in your EBITDA, so there is a disconnect with teams in terms of numbers. If you can highlight a bit more on what it is and the CapEx which we had done in the past; if you could give out the number?

Rajendra Gogri: Yes, as we mentioned earlier this year again because of that order cancellation, that contract will be still at around 35-40% utilized in FY23. The FY23 guidance also we had given only a single growth because there'll be higher depreciation and other expenses, but beyond FY23, FY24, FY25, we will see a significant increase in EBITDA because depreciation and manufacturing expenses will be more or less covered. There will not be much increase in that, so significant jump in the next 3 years in EBITDA will happen because by that time our capacity utilization will reach 80-90%.

Aditya Khetan: Even if I exclude that contract's figures, that was roughly around INR 490 crore for the dicamba plant and for the second was also roughly INR 300 crore so that is into the similar range, but since there are large part of the CapEx, what we had done, that seems that the numbers would still come onto the top line. Is there any sort of additional CapEx we had done on specialty chemicals or pharma, which is yet to flow into our numbers?

Rajendra Gogri: Yes, the first contract was a five step process. So we have this CapEx done through the entire chain and that entire chain will get ramped up. That is the one dichlorobenzene chain which is at a slower ramp rate right now and this we will see in the next 2-3 years, we should be at 90% of capacity utilization in that chain.

Aditya Khetan: So roughly what would be the CapEx what we have taken historically into our numbers, rough CapEx figure would do.

Rajendra Gogri: Yes. I know, overall, this entire CapEx, some of them is still in our WIP, but this chain CapEx will be almost INR 800-1,000 crore, CapEx will be in this chain.

Aditya Khetan: INR 800-1000 crore, would flow into our numbers for the next 2 years.

Rajendra Gogri: Yes.

Aditya Khetan: Sir, your guidance for the next year in terms of EBITDA, you are saying that is into high single digits only?

Rajendra Gogri: Yes. That is what I was trying to mention that next year is still a ramp up, because previous year INR 138 crore was a shortfall fee, which is going off. So we are showing, including shortfall fee number we are saying a single digit growth in EBITDA and the major jump will come in FY24 and FY25 subsequently.

Moderator: Thank you. We have the next question from the line of Abhijit Akella from Kotak Securities. Please go ahead.

Abhijit Akella: Thank you sir, just wanted to clarify on the previous point you mentioned, for the Dicamba project overall it's INR 800-1000 crore CapEx, is it because, I think you had guided to a revenue of about INR 400 crore from the project, so I just wanted to sort of reconcile those two numbers.

Rajendra Gogri: This is entire chain. Dicamba was the last step is INR 400 crore, but then you have a chain of, you know, there are three more chemistries before that. This entire plant, entire chain is moving in a ramp up phase, that is how we have seen it.

Abhijit Akella: On the revenue from the previous chemistries, what will the revenue from the entire chain be?

Rajendra Gogri: That number we will have to dig out.

Abhijit Akella: But it'll be in the same ballpark of say 1:1 CapEx also, is it?

Rajendra Gogri: We will have to see the number.

Abhijit Akella: Okay, fine. Maybe I can connect offline, so thank you so much.

Moderator: Thank you, ladies and gentlemen, that was the last question and we will now close the question queue. I would like to hand the conference back to Mr. Rajendra Gogri for closing comments, please go ahead, sir.

Rajendra Gogri: Thank you everyone for taking out the time to join us on our earnings conference call. Let me close by saying that we are moving in the right direction and have all the ingredients in place to demonstrate superior performance trajectory in the forthcoming years. Not only will this amplify our leadership position, but also enhance value for all the stakeholders. I hope we have addressed all your questions. If you have any further questions, please feel free to contact our Investor Relations team, CDR India and we will address them. Stay safe and we look forward to connecting with all of you again in the next quarter. Thank you once again..

Moderator: Thank you members of the management. 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. Thank you.