Aarti Industries Limited

Q4 & FY '19 Earnings Conference Call Transcript
May 22, 2019

Moderator: Good Day Ladies and Gentlemen and a very warm Welcome to the Aarti Industries Limited Q4 & FY '19 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 '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Shiv Muttoo from CDR India. Thank you and over to you, Sir.

Shiv Muttoo: Good Evening everyone and thank you for joining us on Aarti Industries Q4 & FY '19 Earnings Conference Call. We have with us Mr. Rajendra Gogri – Chairman and Managing Director; Mr. Rashesh Gogri – Vice Chairman and Managing Director, and Mr. Chetan Gandhi – CFO of the company.

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

Now, I would like to invite Mr. Rajendra Gogri to share his views. Over to you, Sir.

Rajendra Gogri: Good Evening and a very warm Welcome to all of you. During FY '19, we have delivered another strong performance crossing a significant milestone with consolidated revenue of over Rs. 5,000 crore. Top line grew 31.7% to Rs. 5,014 crore and profit after tax grew 45.2% to Rs. 483 crore driven by strong contribution across business segments and operating margin expansion. Underlying our growth story was a steady transition to higher value addition in the product mix across multiple value chain. We also had growing demand from customers in key global markets on the back of high-quality products delivered to clients exacting specifications as India continues to be seen as an increasingly important component of global chemical supply chains. We are also seeing a significant increase in domestic demand as imports are increasingly being substituted by local production of downstream products for global markets.

Given the strong performance and cash flow generation, the Board of Directors has declared a final dividend of Rs. 7 per equity share in addition to the interim dividend of Rs. 4 per equity share declared earlier.

The Specialty chemical business grew 33% YoY in FY ‘19 and contributed to 79.3% to our consolidated revenues. We expanded our EBIT margins by 110 bps to 20.6% based on higher utilization of capacity across the various value chains that we operate within. Contribution from downstream products has increased, further supporting the margins. Volume growth for the segment stood at 8% in FY ‘19. We have successfully leveraged our fungible and large product offerings to suitably optimize our product mix towards high margin products, resulting in higher EBIT.

The Pharmaceutical segment delivered a strong growth of 31% in FY ‘19 and margins expanded by 130 bps to 15.5%. The segment performance has improved on the back of higher capacity utilization. We now focus on high growth products basket such as Xanthene derivatives, Pharma API and intermediates in regulated market.

Coming to the Home and Personal Care segment:

The segment margins were impacted due to the increasing input cost. As communicated earlier, with an eye on creating a value for all stakeholders, the demerger of the home and personal care products business is on track and at present the petition has been admitted before the NCLT.

Let me summarize our performance for the fourth quarter:

Revenue grew 18% in Q4 FY ‘19 to Rs. 1,211 crore. Our absolute EBIT, which is a key metric to track performance, net of raw material costs that are broadly linked to the global crude oil prices, grew 36% YoY in Q4 FY ‘19 to Rs. 195 crore. As part of our strategy to safeguard business against currency risk, we have entered into forward contracts to hedge our export contracts. Q4 FY ‘19 saw a positive EBIT impact of Rs. 2.29 crore. Company had further provided for re-evaluation gain on long-term borrowing to the extent of Rs. 2.19 crore as of March 31, 2019, provided under finance cost. PAT grew 47% to Rs. 125 crore in Q4 FY ‘19.

In the Specialty Chemical business:

Revenue grew 17% but our improving product mix has allowed us to expand margin by 350 YoY to 21.8% in Q4 FY ‘19. Volumes in specialty chemical segment grew by 3% in Q4 FY ‘19. We crossed production about 15,800 metric ton of Nitrochlorobenzene during Q4 FY ‘19 as against 17,800 metric tonnes for Q4 FY ‘18. The annual production for NCB was 67,570 metric tonnes as communicated last quarter. We are in the process of expanding NCB capacity from 75,000 to 108,000 metric tonnes per annum to cater to the increasing demand for increasing domestic demand and also for downstream captive requirements. The capacity addition would come up in two phases, Phase 1 in FY ‘20 and Phase 2 in FY ‘21, and would entail an investment of about Rs. 150 crore. We achieved about 60% capacity utilization for our ethylation unit in Dahej SEZ in FY ‘19. Our Nitrotoluene at Jhagadia facility which became operational last year has reached 53% utilization at the end of Q4 FY ‘19.

The Pharmaceuticals segment recorded a growth of 22% in Q4 FY ‘19 to Rs. 213 crore. The HPC segment recorded a revenue growth of 16% to Rs. 79 crore.

During the quarter, we signed $ 125 million supply contract for a new specialty chemical intermediate for global chemical major. The product was co-developed by Aarti Industries with the customer of four years from lab to commercial scale. We expect to clock a 35% EBITDA margin on the contract and total capital outlay will be about $ 18 million.

We continue to execute on our CAPEX plans and have invested of about Rs. 797 crore in FY '19. The major ongoing project includes specialty chemical complex and chlorination plant in Jhagadia in Gujarat, CAPEX for long-term contract at Dahej, API and Pharma intermediate debottlenecking and expansions at Vapi and Tarapur. We are also in the process of setting up our fourth R&D and scale-up unit at Navi Mumbai that will facilitate further enhancement of product portfolio and also help to improve our manufacturing processes. Our planned annual CAPEX for FY '20 will be to the tune of about 1,000 to 1,200 crore.

We have successfully raised Rs. 750 crore via QIP by issuing and allotting 53,68,647 equity shares at an issue price of Rs. 1,397 per equity share. This has been our first capital raise since our IPO in 1992 and we see strong interest from marquee, domestic and international investors. The funds will be utilized to support our planned growth initiatives in areas that provide long-term visibility and has a potential to deliver better returns such as addition of new product value chains, downstream growth in existing value chain, partnering with global majors to improve accesses to market and technology, acquisition of new 100 plus acres greenfield site in Gujarat in addition to the existing 100 acres available at Jhagadia and entry into new chemistries to leverage the upcoming Research and Technology Centre in New Mumbai. This will significantly accelerate the company's ability to capitalize on emerging opportunities in the global chemical industry and help sustain its long-term growth trajectory beyond 2021.

We have strengthened our balance sheet and reduced the debt to equity from 1.3x to 0.85x. We look forward to using the additional capital to accelerate our growth momentum and deliver continuing strong returns over the coming years. For the coming year, we expect the revenue growth at about 15% to 20% at constant raw material price and 12% to 20% PAT growth on the back of higher utilization of various capacities, and also considering the new capacity expected to come up in FY '20. We are seeing all-round growth across our Specialty Chemical and Pharma segments. This business is seeing positive visibility from end-user vertical, a trend that we expect will continue based on the strong demand. India's growing prominence in global supply chain and further recognition of Aarti's own position as a farmers choice for a large number of clients. Operating model built through innovation and chemistry strength, scale and sustainability has created a strong value proposition for our global customers. The planned expansion in various businesses and the transformation of the pharmaceutical business enabled by partner of choice has set us up well for the coming years. Our eyes are set on driving growth and value creation. On that note, I conclude my opening remarks. We would be happy to give you our perspective on any questions that you may have.

Moderator: Thank you very much. Ladies and Gentlemen, we will now begin the question and answer session. The first question is from the line of Surya Patra from Phillip Capital.

Surya Patra: **Congratulations on a great set of numbers.** Sir, if you can clarify what was the impact of the acid plant shutdown and for how many days you have taken in this quarter?

Rajendra Gogri: The acid plant shutdown is generally around 15 to 20 days annual shutdown.

Surya Patra: What was the impact on the business as well as the margin front because of this?

Rajendra Gogri: Basically, there must be overall impact both on the volumes as well as on contribution level because, it should be about generally Rs. 8 to 10 crore.

Surya Patra: On the cost front?

Rajendra Gogri: Yes, because there will be higher cost, because of less production there will be less operating profit in that quarter from acid division.

Surya Patra: So, to the tune of around Rs.8 crore, there would be an impact on the overall cost?

Rajendra Gogri: Yes.

Surya Patra: Whether the revenue also is getting impacted because of this?

Rajendra Gogri: Obviously, there will be decline in sales also from the acid division?

Surya Patra: Can you quantify what could be the revenue loss?

Rashesh Gogri: Around Rs.20 crore.

Surya Patra: Now, secondly again, quarterly we have indicated that what is the FOREX M to M loss or gain on the forward contracts and similarly, what is the revaluation gain or loss on the ECVs on the quarter basis, but can you give indication of those amounts for the full year?

Chetan Gandhi: On an annual aggregate basis, we had a major part of FX loss hitting us in the first half as compared to the second half, the aggregate impact of that would be to the extent of Rs.40 crore which would have taken place in the forward contracts and the borrowing cost there would be a net impact of around Rs.7 crore by way ot revaluation of loans.

Surya Patra: Both these are like FOREX losses?

Rajendra Gogri: These are annual the total numbers.

Surya Patra: On the growth front, in the domestic business for the full year if you see has grown significantly better than the export market, so domestic growth would have been somewhere like 50% kind of, so do you think that is going to be normalizing throughout FY '20 meaningfully, and second relating to that aspect is that, whether we have seen meaningful price appreciation in the domestic market compared to the export prices?

Rajendra Gogri: We have mentioned in the past also that there is increased chemical manufacturing activity in India, which has resulted to higher demand for our product, part of that may be for Indian consumption or part of that may be for global consumption, so that trend is continuing and we will see a good growth in demand in local market in FY '20. All this big contracts are for exports, so we will see a jump in export once those contract numbers kick in from FY '21, but in general we feel that next year continuously there will be more and more demand coming also from India.

Surya Patra: With regard to prices, whether the Indian prices of few of the key products for you is higher than the International prices?

Rajendra Gogri: In general, it will be higher but then you will have to go specific cases especially if you want to export to China where obviously the prices here will be better than them, sometimes in global market, non-Chinese market there can be a variation.

Surya Patra: Is it fair to believe that the Chinese prices of any chemical product is similar to that of the Indian prices, is that correct?

Rajendra Gogri: Basically, chemicals are always sold on specification, so there is not going to be much price differential, customer will always consider what is the landed cost to its factory, and there will not be any significant price differences.

Surya Patra: Because so far as Chinese product prices are concerned, they are higher compared to International prices, so is it the same scenario that is there here in India also?

Rajendra Gogri: In the Chinese prices, whatever they quote in RMB normally they add VAT component, so always we find that number is always higher by 13% or 18% as the case may be, so that is why you always see Chinese prices higher, but when they want to export, they get that VAT refund or incentive, then it comes down.

Surya Patra: We have been in a kind of massive CAPEX phase since some time and we have been undertaking multiple projects also throughout '19, so can you indicate which are the projects that would be capitalizing throughout FY '20 ?

Rajendra Gogri: First contract, that project will be commissioned in Q4 FY '20 and our chlorination expansion in Jhagadia also is expected to commission in Q2 of FY '20, so these are the main projects which will be getting commissioned in addition to various debottlenecking and other expansion in chemicals as well as Pharma. R&D Centre also we expect to start in first half of this year.

Moderator: Thank you. The next question is from the line of Dipesh Mehta from SBICAP Securities.

Dipesh Mehta: Sir, just continuing on the previous question on the CAPEX side, if you can help us understand about the capitalization part and second thing is about the CAPEX, if you can provide some color across segment, the two segments which we generally report and focus on excluding HPC, and how much revenue potential you foresee from the roughly around 1,000 odd crore CAPEX which we plan, and if you can help us understand by when you expect this to be commissioned?

Rajendra Gogri: Basically, our Dahej project that will be commissioned as I mentioned in Q4 of FY '20 and the feedstock for that chlorination plant will be commissioned in this year. Out of that, overall around Rs.150 to 200 crore including normal CAPEX will be going in Pharma, rest will be in chemical segment.

Dipesh Mehta: All the capacity of Rs.1,000 odd crore likely to be commissioned by FY '21 end or you expect it to take maybe 2022?

Rajendra Gogri: Most of the project which are online right now will be commissioned by FY '21, all the projects which are currently under execution. The new contracts which we have signed, the third contract that the work has not yet started, so part of that CAPEX will be done in FY '20 and that also by Q4FY '21 also it is expected to commission, so virtually everything will get commissioned in FY '20 and part of that will be commissioned in FY '21.

Dipesh Mehta: In FY '19, what kind of benefit we have seen from China disruption and specific instance of let us say we have seen some news flow around China, how the price movement happen particularly for us considering that some of the chemicals we have capacity for it?

Rajendra Gogri: Last year about typically about Rs.40 to 50 crore was more because of the Chinese disruption in FY '19. Now, FY '20 we have to see how that disruption plays out. This disruption because of the Chinese explosion and pollution issues, is impacting various products in different ways, some of the product where the downstream is impacted the upstream price are coming under pressure whereas the downstream price are increasing, but overall we see that it will be positive impact for us, overall whichever is the new disruption which has happened in China when you look at the composite way.

Dipesh Mehta: Last question about FOREX gain and loss, presuming Rupee remaining where it is, what kind of gain or loss you expect in FY '20 based on the hedges we have?

Chetan Gandhi: Basically, we got a hedge book of almost around $ 73 million for a period of two to three years, so if Rupee remains or if Rupee depreciates at a rate of forward premium which is roughly around 4%, then we would not have any impact, so the volatility in Rupee how different it is from the forward premium that is what it will determine the impact on this $ 74 million.

Moderator: Thank you. The next question is from the line of Saravanan Vishwanathan from Unifi capital.

S. Vishwanathan: As regard to specialty chemicals segment, what sort of volume growth are we anticipating in FY '20?

Rajendra Gogri: Overall, it is constant, raw material price we are looking at 15% to 20% growth.

S. Vishwanathan: In FY '19 it was only 8%, in Q4 also it was only 3%, but for FY '20, you are again seeing a recovery in volume growth?

Rajendra Gogri: Now, we are putting more on a constant raw material top line because volume growth is not also giving a very clear picture because depending on whether it is a value-added volumes then the impact on EBITDA is more, so we are trying to evaluate which can be the other better metrics to measure the EBITDA change, so this 15% to 20% is more if the raw material prices are similar of current year then the top line growth about 15% to 20%.

S. Vishwanathan: The increased realizations due to the China factor, are here to stay or you see any challenges there?

Rajendra Gogri: It is product to product, last year we had some impact. In some of the product, correction has taken place. Now, this year some other products are impacted in positive and negative way, so it is continuously evolving situation from China. Some of the products which were impacted last year part of that has corrected, but some new have been impacted now so that is the situation.

S. Vishwanathan: At least from a H1 perspective, EBITDA would only show a growth right even if there is some dip in realization because volume growth also is back in line?

Rajendra Gogri: Yes, it will be positive that is why overall bottom line we are guiding about 12% to 20% and depending on the disruption, we will see quarter-to-quarter once we have more and more visibility. The 12% is more on the lower side, but we expect because of all this disruption more towards 20% range, but then we will go on updating.

S. Vishwanathan: In pharmaceuticals also your commentary has been pretty strong, so what gives you that specific confidence?

Rashesh Gogri: Basically, we run three segments particularly in API and intermediates we hope to see stronger growth in volumes going forward and in intermediate, we have started one new block so that we will get occupied and we will have more volumes manufactured going forward.

S. Vishwanathan: This is which therapeutic segment that is seeing faster growth?

Rashesh Gogri: Normally, the best running segment that we have is steroids in API and in intermediates we are mostly doing upcoming generic products as well as we also do products for innovator, so both the segments are showing good growth.

S. Vishwanathan: Is there any concentration you see here or it is reasonably diversified, at the product or the client level?

Rashesh Gogri: We do lot of Ramipril based intermediate, API, and in general, so that is the only one single product where we have sizeable and similarly, we do lot of caffeine, so these two become top two products among the segment which do almost 40% of the total revenue of Pharma.

S. Vishwanathan: In terms of client, is it diversified?

Rashesh Gogri: Yes, in terms of client it is diversified, both the products we are well diversified.

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

Chirag Dagli: Sir, what will be the CAPEX for FY '21?

Rajendra Gogri: Currently, we see around Rs.500 to 600 crore depending on during the year how we time further newer projects, it may change.

Chirag Dagli: But as it stands, so most of the CAPEX for the upcoming projects would have been done by end of FY '20, so that understanding is right, roughly?

Rajendra Gogri: Yes, some will be overflowing in FY '21, but substantial portion will get over, but this new project which we have signed that is going to be commissioned in FY '21 which is about $ 18 million, so that will continue. In addition to that, some other specialty chemical also we are looking at putting up the plant, so all those will start and will have some overlap in the next year also.

Chirag Dagli: Did you indicate Rs.50 crore EBIT benefit on price improvement due to the China factor for the full year of FY '19?

Rajendra Gogri: Yes.

Chirag Dagli: PDA volumes for FY ’19 and what sort of utilization we have had?

Rajendra Gogri: PDA volume is about 5,300 tonnes for FY ’19 and we are looking at reaching about 8,000 tonnes this year, annualized.

Chirag Dagli: This recent China thing does it benefit the PDA volume off take?

Chetan Gandhi: It will benefit PDA volumes, definitely the China plant of PDA has been affected.

Chirag Dagli: What is our capacity in PDA?

Rajendra Gogri: Overall up to 1,000 tonnes is the capacity, but some issues has to be sorted out, but we expect to reach around 700 tonnes in couple of months.

Chirag Dagli: Assuming there is opportunity, can you go beyond the 1,000 metric tonnes capacity?

Rajendra Gogri: Now, we are taking up some debottlenecking process and we are targeting more towards 1,200 tonnes something, but that will take almost more than a year or so, but we are just putting on drawing board, how to further debottleneck the entire PDA part so that subsequent to FY ‘20, ‘21-22 we can have more market, because of this disruption we are seeing a good possibility of longer term higher market for us.

Chirag Dagli: How have market prices behaved in PDA?

Rajendra Gogri: At that time, initially there was a big jump but now it is getting corrected, so I think it will be very dynamic how the prices will move month on month.

Chirag Dagli: A longer-term question, in terms of your return on capital for the Pharma business, should it fundamentally be higher than what you achieve in your specialty chemicals business on full-scale up or what are your thoughts on the longer term?

Rajendra Gogri: Chemicals business is more valuable, more ROC generally will be in chemical in general because the margins in chemical structurally have expanded. Pharma we do not see to those levels of 25% ROC level, but we can reach towards I think 20% level down the line.

Chirag Dagli: That would be at what sales levels?

Rajendra Gogri: In one or two years when we may reach around Rs.1,000 crore.

Moderator: Thank you. The next question is from the line of Jatin from Credit Suisse.

Jatin: In terms of your guidance on 15% to 20% revenue growth and a bottom line of 10% to 20% growth, the margin pressures that you see is largely from the China reversal or are there any other headwinds that you see on margin as well?

Rajendra Gogri: As we say, China there were disruptions in various products last year, some of them have corrected and there are some more disruptions this year, so how the entire China factor is playing out, that is why we have given a broader range of

12% to 20% and depending on how the situation turns up, we will be able to give better guidance on quarter-on-quarter.

Jatin: In terms of your three main kind of end segments on the specialty chemical side, agrochem, polymer, and dyes and pigments, which are the segments which are kind of doing better within the specialty chemical business?

Rajendra Gogri: Across the board actually polymers and pigments and dyes are doing well and agrochemical also there is some shifting of production from China to India, so that also is doing well, so all the three are quite well segment as far as segment wise is concerned.

Jatin: On this new project that you announced, what is the duration of that order for how many years?

Rajendra Gogri: It is for 10 years.

Jatin: One last question, on your CAPEX the Rs.1,000 to Rs.1,200 crore number, if you could just split it into different heads because you mentioned your chlorination expansion plant as one of the largest and that being at Rs.150 crore, so what are the other big ones, I understand Pharma is about Rs.200 odd crore, what are the other big areas where you are spending this money?

Rajendra Gogri: We have signed two contracts in FY '18, so those are the major and CAPEX is going to go into that, so that will be about Rs.400 to 500 crore and we will also be picking up some land.

Jatin: The main is those two contracts chlorination, land and Pharma, those are the main broad heads?

Rajendra Gogri: And there will be normal replacement CAPEX also.

Moderator: Thank you. The next question is from the line of Abhijit Akella from India Infoline.

Abhijit Akella: Sir, first just on the Pharma segment, this quarter we have seen a little bit of a margin dip, so just wondering why that may be and what is the outlook for next year both in terms of margins and growth for the Pharma segment?

Chetan Gandhi: We have seen little bit of pricing pressure in our Xanthene segment particularly that is why we have seen though the top line has grown significantly, we have seen some pressure there and also this quarter we did see some stock reduction, so lot of stock got off dispatched in last month. That has resulted in overall margin erosion in terms of percentage. Next year, we anticipate margins to remain at 16% to 18% range of sales and we expect to grow by 15% to 20% in sales YoY.

Abhijit Akella: Also, just wanted to clarify, in the QIP document on the prospectus we had mentioned about Unit 2 and Unit 3 coming up at GIDC, Bharuch, at a CAPEX of Rs.670 crore. Now, just to clarify whether this is for the two large multi-year deals itself or this is something else that we have mentioned?

Rajendra Gogri: It is for both of these.

Abhijit Akella: At this point, we basically have three multi-year deals that are underway and in addition to that the chlorination project, the R&D Centre and the ongoing debottlenecking?

Rajendra Gogri: In addition to this, we have lot of expansion which are for multi-customer, which are not that for dedicated single customer, so that is a normal business model we are continuously adding capacity for multi-customer businesses.

Abhijit Akella: Last quarter, you had mentioned about API and Pharma intermediate debottlenecking at Vapi and Tarapur, so this is the Rs.150 to 200 crore CAPEX you are mentioning, right?

Rajendra Gogri: Yes. Rs, 160 crore Capex

Abhijit Akella: Specialty chemical complex at Jhagadia that is again the same thing, which you have already mentioned?

Rajendra Gogri: That is chlorination complex is coming there.

Moderator: Thank you. The next question is from the line of Ritesh Gupta from Ambit Capital.

Ritesh Gupta: Have you seen any major improvement in the demand for contract manufacturing, more enquiries let us say in last six to nine months, which can probably give you visibility on the growth beyond FY '21?

Rajendra Gogri: Basically, more and more demand visibility is there and we are seeing that customer are also preferring us because we are totally backward integrated and we are not dependent on any Chinese raw material, so we are seeing a good traction for value-added products demand wise.

Ritesh Gupta: Could you just give us a sense of how much of your raw material is imported from China or you have a China dependency there?

Rajendra Gogri: We have zero Chinese dependency in our chemical segment.

Ritesh Gupta: Sir, in terms of your guidance for the year of 10% to 20% on PAT, which means there has been some bit of erosion in terms of margin, so could you just give us a sense, I know you have discussed that in the previous questions also, but is it something which you are cautionary building in or you have already seen some bit of erosion in certain prices or have you already seen some of the prices kind of eroding let us say in last one or two months?

Rajendra Gogri: As I mentioned in the last year, whatever the disruption was there, some of the product it has corrected some of the new product has come, it is very dynamic. Around 12% what we are seeing it will be not without considering any substantial abnormal prices. So this year depending on how much the abnormality will be there, on that basis the actual final number will come out.

Ritesh Gupta: Last one from my side, on the new R&D Centre that you are putting in, what are the capabilities you are trying to build, is it more catalogue products that you are looking at or you are looking at some more like CRAMS kind of opportunities that you have made there?

Rajendra Gogri: We will be having both, more complex contract manufacturing type also and we are also planning to have more value chain like what we have worked chlorobenzene, Nitrochlorobenzene. We are looking at chlorotoluene, so there will be new chemistry of photochlorination, hydrogenation etc. in that chain and downstream product also, we are seeing further more complex chemistry coming into play, it will be for a very wide range of chemistries.

Ritesh Gupta: If you could just give a sense on the utilization levels of the chlorination and the nitration facilities that you have and also on the toluene facility that you have?

Rajendra Gogri: Nitrotoluene, Q4 was about 53% utilization and Nitrochlorobenzene was around 90%.

Moderator: Thank you. The next question is from the line of Aman Vij from Astute Investments.

Aman Vij: Sir, two questions from my side, one is on the volume growth, so the volume growth for the last three years has been high single digit, I understand the China issue has resulted in higher realization, but why has not the volume growth been in double digits?

Rajendra Gogri: We analyzed that volume growth does not directly mirror the EBITDA growth because it is dependent on whether you are adding value added volumes or low value-added volumes, so quarter and current year also more volume growth has come from value-added products rather than as the first step product. Actually, in this quarter our benzene consumption was less than the last year quarter, so it is more on a type of volume what you had that is giving reflection on the EBITDA.

Aman Vij: For next three years, we should assume similar kind of volume growth because our product mix will be changing or even lower volume but higher margin?

Rajendra Gogri: Basically, we will have come out with a much better metrics because the new contract what we have signed that is 40% EBITDA, so Rs.400 crore is going to be 40% and few other products which is 20% EBITDA, it might show Rs.800 crore and that generic might show substantial higher volume, so we are trying to evolve at some better metrics whether to bifurcate between the two categories or something.

Aman Vij: The second and final question is, our subsidiary revenue if I see consolidated revenue has jumped up by 50 odd percent, so from Rs.100 odd crore to Rs.150 odd crore, could you throw some light on that?

Chetan Gandhi: The subsidiary is into manufacturing of monomer and some specialty chemicals and there we have seen higher pricing in last year due to higher raw material pricing as well as some volume growth also.

Aman Vij: Could you split the volume and value growth in subsidiary?

Chetan Gandhi: I think it will be 50:50%, so half is volume and half is value.

Aman Vij: There is 25% volume growth…

Rajendra Gogri: Yes.

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

Nitin Agarwal: Sir, like the way you have indicated the constant currency growth for next year is going to be 15% to 20%, this year FY '19 growth of 33%, is it possible to get a sense of what would have been the comparable growth in this year?

Rajendra Gogri: We will have to work it out.

Nitin Agarwal: Secondly, on the multi-year contracts, can you just probably help us remind what are the starting time for the commercialization of these contracts?

Rajendra Gogri: The first 10 years contract is the agrochemical intermediate which will be commissioned in this Q4 of FY '20. The second-year contract, which is a 20 year contract, that will be commissioned in first half of FY '21, and third one which we signed this year will be commissioned in Q4 of FY '21.

Nitin Agarwal: By FY '22 all of these three contracts will be pretty much be in full stream in terms of contribution?

Rajendra Gogri: Yes.

Nitin Agarwal: The third quarter that you signed, you mentioned it was sort of a long development project that you were doing with the customer, is this like a one-off contract that you have opportunity or there are several multiple such opportunities which are there with us, where we have been working sort of with customers or innovative products?

Rajendra Gogri: We see these as a separate growth vertical. As I mentioned, there is a customer appetite also for more value-added product to work with us and down the line as we are expanding our R&D capabilities, we see this as a good growth driver in next four to five to 10 years future.

Nitin Agarwal: But you do not anticipate more of these contracts over the next year-and-a-half to two years, I mean some more of these opportunities?

Rajendra Gogri: Right now, I cannot give any specific yes or no on that.

Nitin Agarwal: Lastly on the pharmaceutical segment, are you looking to expand your product portfolio in that segment or it is largely going to be just increased volume off take on the current portfolio?

Rashesh Gogri: We are actually debottlenecking and expanding our API facility as well as our intermediate facility, in both the facilities we are going to put one, one additional block so the capacities will go up by 25% in both the segments. We will see volume growth also from the new facility.

Nitin Agarwal: Are you looking to add products into that five new products or it is largely the older products, the existing five products that we are looking to grow volumes on?

Rashesh Gogri: In Pharma, we have R&D strength of 120 people, we did close to 15 new API R&D and we did more than 50 intermediates where R&D was done and out of which, the products were commercialized and that is why we are creating the space to manufacture them. There will be some product rationalization and there will be growth also.

Nitin Agarwal: Sir, help me understand this, last year we grew our revenue at 33%, a lot of growth you have been mentioning has been driven by value-added products, so why should your gross margins be soft on a YoY basis, ideally should not that lead to an improvement in our gross margins?

Rajendra Gogri: These gross margins of Pharma you are talking about?

Nitin Agarwal: For the overall business?

Rajendra Gogri: Overall business, there is increase of gross margin by about 19% on a year-to-year basis as compared to 18% and as we have been mentioning in the past, raw material price goes on changing, this margin to sales as a percentage will tend to vary, so this will have to be more estimated as a constant raw material prices.

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

Nav Bhardwaj: Just a general question, number one being that many global major chemical companies who are our clients have been giving flat to negative guidance for the coming year, so are we seeing any kind of pressure if not in the volume on the pricing side going ahead right now?

Rajendra Gogri: Overall, we have volume growth also, so we do not see any issue. We are very confident that we will also have EBITDA as well as bottom line growth.

Nav Bhardwaj: What kind of debt levels are we looking for FY '20 and '21?

Chetan Gandhi: I believe that debt level would fairly be similar, I do not see any significant change in the debt for FY '20, we will have to still see as the year goes and how the crude cycle happen. FY '21 you might see some increase in the debt level by around Rs.300 to 400 crore, but we will have to look at the numbers for future.

Moderator: Thank you. The next question is from the line of Chetan Thacker from ASK Investment Managers.

Chetan Thacker: Sir, just wanted the hydrogenation volume for the quarter and the NCB volume?

Rajendra Gogri: NCB volume was 15,800 and hydrogenation was 1,992 per month.

Moderator: Thank you. The next question is from the line of Rohit Nagraj from Sunidhi Securities.

Rohit Nagraj: Sir, my question pertains to the CAPEX that you have guided about Rs.1,000 to 1,200 crore for this year and about Rs.600 crore for next year, does it include the CAPEX for the second long-term contract where we will not be doing any CAPEX, but the client is going to give us advances?

Rajendra Gogri: Yes, it includes that.

Rohit Nagraj: How much that amount would be?

Rajendra Gogri: That is about Rs.270 crore CAPEX.

Rohit Nagraj: Have we already started it and received any advances for the same?

Rajendra Gogri: We have started the project and we also received advance.

Rohit Nagraj: The second question in terms of strategy, in how many years do you feel that the benzene chemistry volume growth probably will stagnate to broader 3% to 4% kind of growth and then what are the new areas in terms of diversification in the new chemistry that we are looking at or we are currently working on?

Rajendra Gogri: Basically, we look at the volume growth in a three-dimension. One will be the global growth, so some of the segments globally are growing which are polymers and some of the agrochemicals which are going from our downstream products, so there the growth are higher. In addition to that, there are import substitution and second is where the customers want to do de-risking, so these are the two other one which are not directly connected to the global growth, but it is more of a shifting from other country, so in our benzene-based products, some of the engineering polymers and agrochemicals where the global growth is maybe 7% to 8% that will continue drive further, in addition to the import substitution and geographic de-risking.

Rohit Nagraj: Any other areas or chemistries that you are looking beyond the existing ones where we have already mastered the chemistry?

Rajendra Gogri: We are also planning to get into Chlorotoluene entire chain and more value added downstream in our existing chain also and we are also planning to identify more such chains.

Rohit Nagraj: Any inquiries from Chinese players for any products from our kitty or the one which we are working on?

Rajendra Gogri: Yes, we have been exporting lot of the products for China for many years. So, time-to-time some of the products are continuous, some of the time if there are mismatches we export on a spot basis also to China.

Moderator: The next question is from the line of Dhaval Shah from Girik Capital.

Dhaval Shah: Sir, in our growth journey going forward while we are executing large projects and entering new segments, my only question as an investor is that, what sort of operational challenges should we keep in mind that we might come across going forward, so one would definitely be a competition, but as a management what operational challenge do you see?

Rajendra Gogri: One thing for a chemical business is safety health environment is going to be the key issue. So, we have also got good talent we have taken on this front and continuously both process and operational safety is a major continuous drive. In addition to that, we have built internal system for talent building because as we grow, we will need human resources. So, for that we are institutionalizing our internal, identifying of the human resource and then training up for them for a higher responsibility.

Dhaval Shah: In terms of safety have we taken help, suggestions or any sort of consulting from global majors in that case or after this, after each several explosions which has happened in China, have we kind of rectified some faults which were there in our plants and do you think there is need to give some sort of information to investors with regard to the safety initiatives taken which you think are material in nature which will help us understand what Aarti is taking steps in terms of the safety standards?

Rajendra Gogri: We have informed in the past also last four, five years we have been continuously investing, we have substantially increased our automation in lot of our plants actually about four years we have spent almost Rs.240 to 250 crore we have spent on this safety health environment linked initiatives on our older plants and all our newer plants we have a very structure process what they call HAZOP and then corresponding safety matrix and automation. So, that is very important so from the beginning, from the process selection to the entire risk association and corresponding mitigation measure.

Dhaval Shah: So, was this something which is missing in the latest explosion in China which killed many people?

Rajendra Gogri: We do not know actually from where it has happened it is may be more on operational mistake or something like we heard that it was maybe on Benzene storage or something, but for Benzene as a company we do not keep any overhead storage for Benzene or Methanol or Toluene kind of solvent. We keep it in underground as a policy because around 15 years back we had one report done that over ground storage can have a huge impact. So, from that we converted our over ground solvent storage to an underground tank and subsequently as a policy we do not keep any bulk storage of Benzene, Methanol, Toluene over ground.

Dhaval Shah: Do you see as China is losing business to the other countries and increased amount of pricing competition or if even China is little bit slowing down they dumping their products in India to our customers, any sort of scenario that have you faced in the past two, three quarters?

Rajendra Gogri: Because of the disruption everything becomes very dynamic. In China if some downstream consumption goes down then they try to sell upstream in other territory and downstream prices goes up. Company like us we may go upstream and downstream and sometimes the downstream we get benefits; upstream we may get hit. So, depending upon so many chemicals, each the impacts are going to be different for different companies, but broadly this is helping especially intermediate chemical industry.

Dhaval Shah: What do you see as a sustainable return on capital for us once you start executing the large projects over a three to five-year period?

Rajendra Gogri: On ROCE basis, we should be in the range of 20% to 25% on a long-term basis. Currently it is lower because we have a lot of capital WIP.

Dhaval Shah: And for the long-term project what we will be executing our working capital cycle would be different similar to what we do?

Rajendra Gogri: It is going to be lower.

Dhaval Shah: So, lower in terms of getting money fast like your receivables will be lower?

Rajendra Gogri: Yes receivable will be lower.

Dhaval Shah: Are they going to supply with the tag pack or we are going to make the tag pack in the contract manufacturing?

Rajendra Gogri: No, one is our own developed second is a jointly developed and third one is where we get the tag pack.

Dhaval Shah: So, the one where you are developing would be having 40% margin?

Rajendra Gogri: Yes.

Dhaval Shah: And the one you are getting a tech pack would be 20% or lower?

Rajendra Gogri: We are getting money also there, hence there is no interest cost or anything. So, it will be direct the EBIDTA will directly flow into PBT. Since it's an SEZ we have to count as a PAT level margins vs the company similar margin.

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

Chirag Dagli: So, what is the loan mark-to-market on FOREX for FY19 that we have included in the interest cost?

Chetan Gandhi: So, the net impact is Rs.7 crore.

Chirag Dagli: Rs.7 crore loss?

Chetan Gandhi: Yes Rs.7 crore loss.

Chirag Dagli: Conceptually so if you look into your financials Rs.800 crore CWIP capital work in progress that is lying currently and then Rs.1,200 crore you will spent in FY20, so what is the sort of peak EBITDA or EBIT that you can generate on this Rs.2,000 crore it is a fairly large number, what sort of peak EBIT or EBITDA if you have any thoughts on that?

Rajendra Gogri: No, I have to put those numbers to arrive at the peak on this.

Chirag Dagli: It will take two, three years for that peak to be achieved?

Rajendra Gogri: Yes FY21 this will be commissioned so by FY23 I think 23, 24 virtually everything will come on peak level.

Chirag Dagli: Conceptually once these price hikes are in the base in FY20 and then you execute on these newer projects, FY21 should be a substantially good year versus the 12% to 20% PAT growth that you are indicating for FY20?

Rajendra Gogri: Yes, that is where more volumes will kick in.

Chirag Dagli: From these two projects as well as the pricing will also be in the place?

Rajendra Gogri: And value-added volumes will be the place.

Chirag Dagli: Value added volumes in which products?

Rajendra Gogri: So, that is a 40% EBITDA so the turnover may not increase, but the EBITDA increase will be substantial.

Chirag Dagli: On the base business in PDA and NCB Nitrotoluene, how does FY21 look versus FY20?

Rajendra Gogri: There also we will have a volume increase all across the chain. The Nitrochlorobenzene expansion also first phase will be over in FY20. So, we will have volume growth in Nitrochlorobenzene in FY21 and Nitrotoluene also we expect higher production subsequently in FY21. FY21 the traditional all the other than the main contracts the volumes will continue to increase over FY20.

Chirag Dagli: What will be your blended interest cost?

Chetan Gandhi: I could not understand your question.

Chirag Dagli: What will be the rate of interest?

Chetan Gandhi: The blended interest rate should be around, that will be still sub 9%.

Chirag Dagli: So what has happened in FY19 is a fair indication of what future can look like?

Chetan Gandhi: At least for next year I do not see any major change in the interest cost or in the interest rate perspective. So, I believe we could see the interest cost largely to be flat or marginally lower.

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

Surya Patra: Sir you indicated about the chlorination unit which is the Chlorotoluene unit I think and this is the captive base for our Nitrotoluene as well as the new contracts, the first multiyear supply contract is that right?

Rajendra Gogri: Its Chlorobenzene not Chlorotoluene.

Surya Patra: And when is the Chlorotoluene expected to commission?

Rajendra Gogri: Chlorotoluene is still on the drawing board that is a new chain which we are going to start, that is two, three years away.

Surya Patra: So, Chlorotoluene is not there in the near future then.

Rajendra Gogri: We will be targeting to start construction of the plant may be in FY20 and commercial production may be in FY22 from Chlorotoluene.

Surya Patra: Just one more question on the pharma side, so how is the earning profile or the EBITDA profile or EBIT profile of this caffeine products versus the pharma intermediate and Xanthene product?

Chetan Gandhi: We will get back to you.

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

Jatin: This is Jatin. Just one quick question on your staff costs, we have seen this increase significantly through the years from Rs.50 odd crore run rate in the first half we are at Rs.70 crore in this quarter, so just wanted to check if there is any one off in this quarter or should we assume this as a sustainable rate going forward?

Rajendra Gogri: We have basically increased our overall strength especially in operations in safety and then other functions process and all. So, this will be more of a long term about Rs.5 crore is something which is more this year, but in general overall other than that will be more of long term.

Jatin: So, Rs.5 crore is kind of one off for the quarter or for the full year?

Rajendra Gogri: For the quarter.

Jatin: And in terms of the benefit from the lower Benzene prices have you started seeing that kind of pass through coming through your P&L or will that happen going forward?

Rajendra Gogri: Domestic rate changes happens in the quarter itself, but for exports it is a with quarters lag.

Moderator: The next question is from the line of Tanmay Mehta from SBICAP Securities.

Tanmay Mehta: Sir just wanted to know how is the raw material environment shaping up because we see that chlorine prices are positive after a long time, so if you could just give a sense on the key raw materials and the pricing of that?

Rajendra Gogri: Yes FY19 the chlorine has generally remained on positive and FY20 also it should remain on the similar positive sides. FY18 was a negative number as far as chlorine is concerned.

Moderator: The next question is from the line of Bhavya Shah from Girik Capital.

Bhavya Shah: Sir just wanted to have guidance on effective tax rate after like four or five years down the line right now we are enjoying that benefit because of our project in SEZ and I believe more few projects are coming up in SEZ, so will this tax rate continue for next five years?

Chetan Gandhi: We should be somewhere around 22% for next four years or five years.

Bhavya Shah: So, 22% for next four to five years.

Rajendra Gogri: That is what we anticipate.

Moderator: As there are no further questions. I now hand the conference over to Rajendra Gogri for closing comments.

Rajendra Gogri: Yes it has been a pleasure interacting with you over the call. We thank you for taking time out and engaging with us today. We value your continued interest and support, if you have any further questions, or would like to know more about the company, kindly reach our Investor Relations Desk. Thank you.

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