Aarti Industries Limited
Q2 & H1FY21 Earnings Conference Call
November 11, 2020

Moderator: Ladies and gentlemen, good day and welcome to Aarti Industries Limited Q2 & H1FY21 Earnings Conference Call. As a reminder, all participant lines will be in listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing * then 0 on your touchtone phone. Please note 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: Thanks, Bikram. Good afternoon, everyone. Thank you for joining us on the Aarti Industries Q1 FY21 Earnings Conference Call. We have with us today on this call Mr. Rajendra Gogri – Chairman and Managing Director of the Company, Mr. Rashesh Gogri – Vice Chairman and Managing Director and Mr. Chetan Gandhi – the CFO of the company.

Before we begin the call, I would like to point out that some statements made in today's call maybe forward-looking in nature and a disclaimer to this affect has been included in the results presentation shared with you.

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

Rajendra Gogri: Thank you. Good evening and a very warm welcome to all of you. Firstly, I hope all of you and your families are in good health as we all collectively deal with the difficult situation over the last several months. I trust that all of you would have received Q2 FY21 Financial Results Presentation that has been uploaded on the stock exchange website earlier today.

Q2 performance was largely in line with what was discussed by us during the last concall. In Q2 we saw the recovery coming in gradually in the Specialty Chemical segment with most units now operating at about 80-90% level. Domestic sales, which were majorly impacted in Q1, saw recoveries with customers commencing the resumption of their operation. The financial performance in Q2 has seen a significant scale up compared to Q1. During Q2, the consolidated revenue expanded by 23.5% YoY to Rs. 1,330 crore, driven by expanding volumes in both domestic and exports as we gain traction in new markets for discretionary products. We have also gained visibility from customers based on the recovery in their end use application more specifically for the discretionary end-use segment.

Pharma segment also continues to scale up and grow. The CAPEX spend for the quarter was Rs. 302 crores while for the first half, the CAPEX spend was about Rs. 526 crore and expect the annual CAPEX within the range of Rs. 1,000-1200 crore for FY21. During the quarter, we partly commercialized the new chlorination unit at Jhagadia. This along with the projects commissioned in the earlier part of the calendar year has resulted in the increase in fixed cost which should normalize as operating leverage kicks in with the increase in volumes going forward. Our other expansion projects are also progressing as per the plan and will be commissioned progressively in H2 FY21 and a few are to be commissioned in the next financial year. This will drive stronger growth over the next year and further periods.

This quarter saw the recovery phase with gross income from operations for the company on a standalone basis at Rs. 1,278 crore, EBITDA at Rs. 241 crore and PBT of Rs. 167 crore and PAT of Rs. 136 crores. While on the consolidated basis, the gross income was Rs. 1,330 crore for Q2 FY21, about 23.5% higher as compared to Rs. 1,077 crore for Q2 FY20. Consolidated EBITDA similarly was at Rs. 250 crores for both the periods and the consolidated PAT for Q2 FY21 was low at Rs. 140 crores as compared to Rs. 148 crores for Q2 FY20.

Let me walk you through the segmental performance and share the insights on the same. With the intent to increase the volumes for the discretionary spend which has been impacted significantly due to COVID-19, we had explored the non-regular market to provide for additional revenue for expanding our presence in discretionary space. This has impacted the overall margin but helped in gaining market share, expand presence in non-regular markets and liquidate inventory. We have been able to supply significant quantities into China thereby leading to our exports to China hitting 20% of the export revenues as compared to the normal share of about 8%. This is also visible in segment financials.

During Q2 FY21, the Specialty Chemical segment reported consolidated segment revenue of Rs. 1,109 crore as compared to Rs. 895 crores in Q2 FY20, an annual revenue of Rs. 3,865 crores by FY20. The consolidated EBIT for segment was Rs. 190 crores for Q2 FY21 thereby generating EBIT margin of 17% as compared to the EBIT of Rs. 214 crore and EBIT margin of 24% for Q2 FY20; the annual EBIT of Rs. 814 crores resulted in an annual EBIT margin of 21% for FY20. I would also like to highlight that the YoY comparison for margins may not be the right method to see the Q2 performance. As you would recollect during Q2 last year, we had faced some raw material supply limitations specifically related to Nitric Acid that has resulted in the volume for some of our products to be lower than planned. As a result of the shortage, the price of the products with high demand had temporarily moved up resulting into higher margins in that quarter.

Now for the Q2 production update – there has been a higher scale –up in production following reduction in lockdown restrictions and volumes have been expanding. Production for Nitro Chloro Benzene was about 17,830 metric tons for Q2 as compared to 13,945 metric tons a year back. Similarly for Hydrogenated products, we achieved production of about 3,040 metric tons as compared to 2,003 metric tons per month last year. On the Nitro Toluene front, the production in Q2 was about 4,120 metric tons which was about 1,363 metric tons in the same quarter last year. At present, as I said earlier, we are operating at ~80-90% capacity utilization across locations and expect the improvement in operating and financial performance through the second half as compared to the current financial year.

Moving to the Pharma segment – during Q2 FY21, the Pharma segment reported consolidated segment revenue of Rs. 222 crore as compared to Rs. 182 crores for Q2 FY20, an annual revenue of Rs. 756 crores for FY20. The consolidated EBIT for the segment was Rs. 57 crores for Q2 FY21 and thereby generating an EBIT margin of 26% as compared to the EBIT of Rs. 34 crores for Q2 FY20 and EBIT margin of 19%. The annual EBIT of Rs. 137 crores resulted into EBIT margin of

18% for FY20. Our Pharma business continues to grow and see operating leverage based on the increasing volumes as the demand remains intact. Pharma revenue growth was being driven by increasing contribution from regulated markets and value-added products. We delivered record profit in segment and margins expanded over 25%.

Continued growth in operating leverage likely to be maintained in the near term. Further, we are witnessing a structural margin expansion for Indian manufactured API and intermediates along with a strong long-term demand which will drive growth for this segment in the coming years. Ongoing expansion of API and intermediate facilities is expected to be progressively commercialized in next 2-3 quarters which will allow the momentum to sustain. Going forward, capacity expansion will drive deeper penetration in therapies such as anti-hypertensive, cardiovascular, oncology, cardiovascular etc. We also have a strong pipeline of approvals and visibility to maintain our growth. We have been witnessing various growth opportunities flowing in for Indian Pharma manufacturing from a global standpoint which is also well supported by the Government's 'Atmanirbhar' initiative. With this kind of opportunity, we are working on a bucket list of new Pharma products which we would like to expand in the future. With this rationale, we have acquired a large parcel of land in Gujarat, we are at the drawing board stage on these opportunities and we will share more details as we move forward.

To summarize the Q2 performance – gross income from operation expanded by 23.5%, profit margins were impacted due to the factors discussed earlier apart from higher depreciation on new facilities and lower other income. Also to highlight for the quarter, we have recognized revenue of around US$ 5 million during Q2 just as we did in Q1 being the shortfall fees eligible as per the terms of the long-term contract discussed previously. Overall, we are satisfied with Q2 performance and look forward to operational improvements and higher performance during the course of the second half. We continue with our guidance of full year profits to be flattish and expect significant growth momentum from FY22 onwards.

Our focus on expanding value-added product chemistry and value chains in the portfolio has allowed us to emerge as a leading global partner to growing list of innovator companies. Also with a view to enhancing long term prospects of the business, we have been investing in organizational competencies including R&D initiatives, SHE excellence, talent acquisition and greater process orientation, benchmarking ourselves with the best-in-class global practices. Added to these positives is India's rapid response as a leading supplier of chemical intermediates and is likely to increase the country's share in a global market. Aarti Industries is well positioned to benefit from these trends.

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

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question and answer session. We have our first question from the line of Rohit Nagraj from Sunidhi Securities. Please go ahead.

Rohit Nagraj: On the land that has been purchased – what would be the amount spent and its area? With a CAPEX plan of ~Rs. 1,000 crore per year, what would be the area of land available for future expansion and how many years would it be sufficient for?

Chetan Gandhi: The land parcel has been procured in Gujarat with the total parcel size being close to 105 acres and its in the Dahej belt. This will be utilized for Pharma and Chemicals; the larger parcel being utilized for Pharma.

Rajendra Gogri: In addition to that, the Company has an available land parcel of 75 acres in Jhagadia which shall be used for the chemical segment.

Rohit Nagraj: Given the current expansion, how many years would the land be available for i.e., till it gets exhausted and to procure a new land parcel?

Rajendra Gogri: Yes, with the 75 acres of land in Jhagadia and some more in new location, the next 3-4 years should be sufficient for the project; for Pharma it could be even longer and for Chemicals – about 3-4 years.

Rohit Nagraj: What would be the timeline for the commissioning of long-term projects? Has there been any delay or are they on track; this is with reference to the Rs. 10,000 crore and the US$ 125 million projects?

Rajendra Gogri: The first one will be commissioned in Q4 and the second one of Rs. 10,000 crore is expected to be in first half of next financial year.

Rohit Nagraj: Earlier, it was to be in the second half of this financial year; there is a delay ~3-6 months, is that correct?

Rajendra Gogri: Yes, there is some delay in the second project because of equipment related issue.

Moderator: Thank you. We have next question from the line of Sudarshan Padmanabhan from Sundaram Mutual Fund. Please go ahead.

S. Padmanabhan: On Specialty Chemicals and the margins; When you talk about witnessing recovery in the nonessentials, how much is the recovery now, versus pre-COVID? Should the margins trend back to normalcy?

Rajendra Gogri: Domestic demand for discretionary in Q3 is almost reaching pre-COVID levels. For exports, it should see the effect in the next 2-3 quarters. Going forward, the Company will see improvement in margins in the discretionary segment.

S. Padmanabhan: Would it mean that the product mix would go back to where it was from the second quarter?

Rajendra Gogri: Yes; also the market will go more towards a regular market which will have a higher margin. Thus, progressively, the margins will increase.

S. Padmanabhan: The Company has been working on more complex chemistries, moving up the value chain. In FY23 or in 2-3 years' time, with the land being utilized, what are the kind of margins and ROCE that can be expected?

Rajendra Gogri: The margins and ROCE will improve progressively. However, ROCE would depend on the capacity utilization at that time.

S. Padmanabhan: On being 'Atmanirbhar' – given that this was announced earlier this year, when would the Company start seeing the benefits as far as the business from its clients is concerned?

Rajendra Gogri: Some of the Company's Pharma APIs are from the products that were announced in 'Atmanirbhar'. Raw materials were also made for that. This would reflect and there is an expectation of a similar scheme for Chemicals also which would directly and indirectly benefit the Company. Overall, the intermediate demand is increasing in India.

Moderator: Thank you. We have next question from the line of Naushad Chaudhary from Systematix Group. Please go ahead.

Naushad Chaudhary: How much of the inventory has been liquidated in this quarter, which products were in that inventory and how were the margins impacted?

Chetan Gandhi: It is not a single product's inventory. There are multiple products on the discretionary side which are helping. The Company was initially operating at 50%, at the start of the year and gradually ramped up to 80%. On the discretionary side, the demand was significantly lower from the regular market and there was an inventory which was piled up. In the Q1 numbers, the inventories were to the extent of Rs. 46 crore which was higher as compared to Q4 numbers. These are the kind of inventories which are being looked at to be cleared out and for supplying to the non-regular markets.

Naushad Chaudhary: So it was just up Rs. 46 crore of inventory which we…

Chetan Gandhi: No, it is not just the Rs. 46 crores, there is more i.e., the QoQ impact. There were other inventories as well. If you want to look at the value specifically, then I do not have that number right now. However, to provide a perspective, there was a higher inventory pile up which the Company looked at, by way of supplying to the non-regular market and hence converting it to cash. It also helps in terms of adding an additional market and allows for further diversification on an overall basis which could likely help on a long term basis.

Naushad Chaudhary: In terms of margin – how much was the EBITDA impacted?

Chetan Gandhi: It will be difficult to state a specific number to it.

Naushad Chaudhary: Is this a part of the regular business or was this a one-off that was witnessed?

Rajendra Gogri: If there is additional capacity or material available, it can be sold to a non-regular market and will generally be as per the demand.

Naushad Chaudhary: Would it be correct to assume that it is a part of the business and this could be seen in the coming years as well, that if there is not much demand in the regular market, then it can be diverted to the non-regular market?

Rajendra Gogri: Yes, it can be diverted to the non-regular market.

Naushad Chaudhary: The Company has partly commissioned a Chlorination business which initially had a capacity of 65,000 tons per annum. How much of it has been started and what is the rationale behind starting the plant partially?

Rajendra Gogri: It is partly commissioned because this is the first phase. In Chlorination products, it is a sequential commissioning i.e., the first part is commissioned and the second part is under commissioning. It will get fully commissioned by the end of this quarter.

Naushad Chaudhary: How do you see the ramp up of this capacity?

Rajendra Gogri: That will take at least 2-3 years; which would be a very steep jump in the capacities.

Naushad Chaudhary: What would be the PDA volume number of this quarter?

Chetan Gandhi: The PDA volumes for the quarter are ~470 tons of monthly production which in Q1 was around ~360 tons.

Naushad Chaudhary: Was the Nitro Toluene number 4,120 metric tons in this quarter?

Chetan Gandhi: Yes.

Moderator: Thank you. We have the next question from the line of Surya Patra from Phillip Capital. Please go ahead.

Surya Patra: On the margins – due to the product mix, there has been an impact on the gross margin and hence the overall margins as well. In the previous quarter, there was an issue in terms of other expenses due to higher spends relating to the COVID-19; although the gross margin was better, the ebit was slightly lower due these spends. The industry has witnessed a kind of a marked improvement in the overall margins on account of the improving spread owing to lower or sharp correction in the crude prices; contrary to that, the Company was impacted in terms of margins over the last 3 quarters i.e., since the price of crude corrected. Could you please clarify this; also, what would be the outlook for the second half or going ahead?

Rajendra Gogri: The Company is crude neutral and uses a raw material pass-through model. Actually, when the crude prices fall, it impacts our business resulting into inventory losses. Lower or higher crude prices do not impact the business as far as the margins are concerned. It is just on the discretionary aspect that the demand is under pressure which is leading to lower margins.

Surya Patra: Would it be expected to sustain longer or just for this financial year?

Rajendra Gogri: Progressively, it will reduce. The domestic demand is virtually reaching to pre-COVID levels and for exports, it is progressively increasing. The margin, on a QoQ basis should go on increasing.

Surya Patra: The domestic business saw a sharp improvement sequentially. Ideally this should have added to the margin expansion. However, there has not been any meaningful margin expansion sequentially.

Rajendra Gogri: We had mentioned that the expenses also have increased which affected the margin at the EBIT level. This was due to depreciation and fixed overheads for the new plants that have been commissioned.

Surya Patra: The Dicamba supply contract was cancelled, following which there was a development that the US court ordered on Dicamba; the Company now has the facility ready and is extending the new phase for another 5 years. Should it be looked at in positive light as – the compensation is adequate, the facility is ready and there is a visible global business opportunity?

Rajendra Gogri: Yes, correct. Recently, the US Government gave a 5-year extension for all Dicamba related formulations. This is a very positive sign for that industry and will increase the Dicamba demand going forward. We had mentioned earlier that, the Company will be participating in this as the customer is ultimately going to buy Dicamba and would not be manufacturing it. We would be looking at a tie-up with Dicamba manufacturers and may also look at setting up a part facility. There are a couple of options; we may decide on both of them or only one of them. This development is a good sign. It will increase the Dicamba demand and correspondingly, the Company would be able to supply intermediates.

Surya Patra: Has the compensation been decided on?

Rajendra Gogri: Yes.

Surya Patra: On the Polymer project – the guidance was for it to likely start from the fourth quarter. How would the utilization be given the COVID-19 uncertainties; would it be staggered compared to the earlier stance? What is the expectation in terms of starting the supplies and ramping up there?

Rajendra Gogri: No, the commissioning, instead of in Q4, is now expected in Q1 of the next year. There will be a delay related to equipment and would also likely witness an impact on the demand; from the customer's side as well, the pool is less. However, the project will be commissioned in the next year.

Surya Patra: How would the first year be in terms of utilization?

Rajendra Gogri: In the first year, it may be ~50% or so.

Moderator: Thank you, sir. We have next question from the line of Sneha Talreja from Edelweiss. Please go ahead.

Sneha Talreja: On Specialty Chemicals, what is the utilization now versus the last year?

Rajendra Gogri: Last year, Q2 was impacted. Thus the YoY numbers in this quarter were higher than last year. It is currently ~80-90% and most of the plants are running.

Sneha Talreja: Which is the same as what Q1 ended with?

Rajendra Gogri: Yes. In Q1, the first month was only 50%; it has reached ~80% in May-June.

Sneha Talreja: It was mentioned that Specialty Chemicals' margins will see an inch up once the discretionary spends' product sales start again and likewise with Pharma. Pharma margins have almost touched the peak of what the Company has ever achieved. Is it due to a temporary or one-off element or would this margin sustain because of the product mix and the rupee depreciation?

Rashesh Gogri: The Pharma margin has moved to a reasonably healthy level. The current capacities are being fully utilized and the new expansion will also take place. In terms of EBIT percentages, it is a good number; anything above 25% is a good number. Overall, there will be QoQ and YoY growth because of the new capacity additions that will come in over the years.

Moderator: Thank you. We have next question from the line of Chetan Thacker from ASK Investment Managers. Please go ahead.

Chetan Thacker: What is the capacity already commissioned for Chlorination and the PDA volume?

Rajendra Gogri: The Monochlorination step has just started and the Dichlorination step is yet to be started. That is why it is part commissioning in that sense.

Chetan Gandhi: To add on that, the PDA volumes for the quarter is 470 tons per month.

Moderator: Thank you, sir. We have next question from the line of Keshav Lahoti from Angel Broking. Please go ahead.

Keshav Lahoti: There is a China story that is playing out for the entire Chemical industry. The Company being one of the beneficiaries of it, what would be the export share as a percentage of revenue, going forward?

Rajendra Gogri: The manufacturing in India is increasing and there is good traction of the material that is being sold within India itself. Exports in the range of ~40-50% level might remain for the Company and the sales in India might increase which will then be indirectly exported by our customers – like some products sold in India, 100% it is used for export.

Keshav Lahoti: Would that mean that there is traction with the export pie increasing?

Rajendra Gogri: Yes, as a country, the export pie will increase. Then, a part of that will be supplied by us to the people who will make agrochemical molecules, advanced intermediates or pharmaceuticals which will get exported. Thus, for some of the Agro intermediates that the Company has shared in India, the finished molecule is not consumed in India and gets 100% exported.

Keshav Lahoti: On contract one which got cancelled – the Company is likely not supplying to the concerned party; for that product is the Company manufacturing a product and supplying it in the domestic or international markets?

Rajendra Gogri: No, the second phase of that project will be commissioned only in Q4 of this year.

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

Archit Joshi: The Company had divided the US$20 million bullet payment from the cancellation of the contract in the four quarters and I think they had uploaded approximately US $5 odd million in the first quarter. Would the same have been done this time around?

Chetan Gandhi: Yes.

Archit Joshi: The Company is expecting this stream of cash in its balance sheet by the end of this year. Is it on track in terms of receiving that amount of money or would there be any delays in getting that?

Chetan Gandhi: No, it is as per the contract terms. There is no change on that.

Archit Joshi: The US$5 million which is approximately Rs. 35-37 crores, this should directly flow into the EBITDA or PBT. If that is removed from the sales and EBITDA, the margin is even lower. Has there been any, other than the discretionary items that the Company has been selling in the export market, new normal that the Company has witnessed in terms of the Tier A and Tier B buckets of the commodity products? Is there any correction which could be the new normal in terms of realization?

Rajendra Gogri: No, other than the discretionary products, there is no impact on the margins be it in Agro, Pharma or FMCG.

Chetan Gandhi: Other than that, there are certain expenses and costs which are charged on a fixed cost basis related to that contract. It is not that the entire US$ 5 million goes directly to the bottom line; there is an expense charge which is also there towards that.

Archit Joshi: On the first contract, is it that the second phase will be commissioned in the fourth quarter? What is this phase exactly and what would be the alternative routes of applications from the plant that had been partly capitalized in FY20 or the first quarter?

Rajendra Gogri: The product has other usages also and can be sold to others. The product Dicamba is going to be manufactured by various companies and we will be selling the intermediates to them.

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

Rohit Sinha: Bodal is also looking at entering the Benzene derivatives space. Would they be competing with the Company's products line?

Rajendra Gogri: We are yet to see a press note on the same, but the NCB demand is expected to substantially increase. May be that could be the trigger; not sure.

Moderator: Thank you, sir. We have next question from the line of Naushad Chaudhary from Systematix Group. Please go ahead.

Naushad Chaudhary: A clarification on the inventory and margins – looking at the balance sheet, there is hardly any change in terms of the inventory comparing it with March '20. Is there any pending inventory which is expected to be liquidated in this/ the coming quarter or is the Company building up on new product inventory?

Rajendra Gogri: Inventories are in a routine course. The build up took place in the first quarter, when the regular market was not picking up the material. Due to this, we sold it to a non-regular market. Now, there is no building up of the inventory. Whatever the Company produces will be sold to its regular market or non-regular market.

Naushad Chaudhary: The Company has two reasons for the drop in margins in this quarter. First, is the inventory. Second, is the Chlorination plant which has been started and is at 50%. Looking at the positive side, there has been substantial volume growth of ~30-35% in the key products; the utilization also was very good, there was recognition of Rs. 35-40 crore from the long term contract and Nitro Toluene recovered from the raw material related issue that took place last year. Despite these, there is a drop of 700 bps in the margin of the Chemical's segment. What dragged the margin?

Rajendra Gogri: It is due to the new projects that have been commissioned; there will be a fixed cost. Due to this, the depreciation has increased and is higher. There are some COVID-19 related expenses as well. Also, on the discretionary side there is a pressure on the margins and in the non-regular market, the margins are still lower. There is a broader price pressure in the discretionary segment and impacts the Company when it sells to the non-regular market. Going forward, the margins should improve on a QoQ basis.

Naushad Chaudhary: Would it be likely to move towards 20-22% from the next quarter onwards?

Rajendra Gogri: It will progressively increase; the utilization will increase and the market spread will also get better.

Chetan Gandhi: Another point to add is that – looking at the inventory days on an overall basis, the inventory days have fallen by more than 10%; this might just give some perspective.

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

Harsh Bhatia: On the Dicamba expansion – the capacity has already been expanded for other users. Would the supply the of the intermediate be exported or domestically sold; if exported, would it cater to US or Europe?

Rajendra Gogri: The Company would be supplying to the manufacturer of Dicamba who is in India or China. They would make the product and then sell it either in US, Latin America or anywhere else.

Harsh Bhatia: Would the supply be towards the domestic or Chinese market?

Rajendra Gogri: The intermediates would be made here. The major market for Dicamba is more in US and Latin America.

Harsh Bhatia: As opposed to Europe?

Rajendra Gogri: Yes.

Harsh Bhatia: In the opening remarks, it was mentioned that significant quantities in Q2 were taken to China i.e., ~20% versus ~8% which is the normal case. Would that be correct?

Rajendra Gogri: Yes, the percentage of exports to China increased from ~8% to 20%.

Harsh Bhatia: Would this be pertaining to a specific product or could this be the new normal, going forward?

Rajendra Gogri: Yes, that was the aim as the demand in discretionary spends of the regular market was impacted. Thus, after the accumulation of inventory in the first quarter, we decided to go for a newer market, identified customers in China and supplied to them. This would be good for the Company on a long-term basis and would allow us to tap into that market, as and when required. We do have a regular market, for some of our products in China; for some products with a lesser margin, it might become a one-off kind of a market.

Harsh Bhatia: Then going forward a range of 15-20% could be expected from the Chinese market, right? That is it from my end. Thank you so much.

Moderator: Thank you, sir. We have next question from the line of Nitin Agarwal from IDFC Securities. Please go ahead.

Nitin Agarwal: On Pharma – there was a mention of a lot of newer opportunities coming into play and a larger CAPEX expansion. What is the nature of these opportunities that is different than the business earlier?

Rashesh Gogri: We would be concentrating on the intermediates and CDMO part of the intermediates' business, apart from the API business, going forward. Thus, in this area, based on our chemistry skillset and the customer's base, we would be able to gain significant growth here.

Nitin Agarwal: What does CDMO pertain to; would this be pertaining to global innovators that the Company could be working with for further intermediates?

Rashesh Gogri: Yes, the Company would be working with global innovators. Also, we are specialized in Onco products and there are a lot of generic companies who do not have their own Onco capabilities; thus these would also apply. The Company is also doing a lot of backward integrated work for them as well. For any Onco product that would need to be commercialized, it would require a vertical and they are trying to create a virtual vertical for themselves.

Nitin Agarwal: On the Onco capabilities, would these products be intermediates of APIs for the Oncology products?

Rashesh Gogri: Both.

Nitin Agarwal: With this put together, would the Pharma proportion increase meaningfully over the next 3-4 years?

Rashesh Gogri: The overall Chemical segment is going to grow significantly. Pharma will also grow. For Pharma, in the next couple of years, we anticipate 15-20% of topline growth because of the new facilities that are coming up and a large facility that we plan to build which will be commissioned after that i.e., after a couple of years.

Nitin Agarwal: On the Chemical segment – during COVID-19, has the Company witnessed any changes in demand patterns which show positivity – global or domestic, on the business outlook?

Rajendra Gogri: Discretionary demand has been impacted in textiles, construction, automobile and the like; this is expected. There is an impact on demand from the global perspective and the domestic demand has not picked up to pre-COVID levels.

Nitin Agarwal: On the new chemistries – the Company is looking at working on these; has it identified what those platforms or capabilities would be?

Rajendra Gogri: Yes, the Company would be entering into the Chlorotoluene range which has a lot of different chemistries coming up.

Nitin Agarwal: Earlier, the guidance was that the Company should be able to compound its profits by ~20-25% on a 3-5 year basis. This year is essentially the blip year; how should the guidance be looked at over the next 3 years?

Rajendra Gogri: The guidance is for 15-20%, not 20-25%; it should not be an issue.

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

Abhijit Akella: On the Dicamba intermediate project – have the plans been firmed up and is the Company going ahead with a specific manufacturing capacity by the end of this year?

Rajendra Gogri: The plant will get commissioned this year, i.e., by end of the year.

Chetan Gandhi: I guess, Abhijit, just clarified the question is in relation to setting up the Dicamba facility.

Rajendra Gogri: No, not Dicamba, our intermediate plant.

Chetan Gandhi: I think the question was not related to that.

Abhijit Akella: I understand that the Company has plans to do both or maybe a combination of both; thus, has it been finalized on whether it would be intermediates or finished products?

Rajendra Gogri: The Company would certainly be making intermediates. Regarding the finished products, there has not been a decision on it as it will take time to understand how the demand would grow in Dicamba. It is being evaluated and has been taken up in the R&D and the like.

Abhijit Akella: On the intermediate – is there customer visibility now in terms of market opportunity?

Rajendra Gogri: Yes, there are possibilities for selling it.

Abhijit Akella: On the discretionary portfolio – is it correct to interpret that ~40-50% of the Company's Speciality Chemicals' sales pertaining to auto, construction and the like? These products were impacted in the quarter; would there be improvement from Q3 onwards in terms of margins and prices?

Rajendra Gogri: This was discussed earlier, that going forward the margins should improve QoQ.

Abhijit Akella: The plants are running at ~90% utilization; which segment is a drag on the overall utilization?

Rajendra Gogri: The Company is able to sell some of the products; however, some will remain. The capacity remains underutilized in some products.

Abhijit Akella: On the Chlorination project – what would be the cost of the project and how much did the fixed cost increase because of that?

Chetan Gandhi: The project CAPEX was more than Rs. 200 crores. We do not have the specific number on the fixed cost and would have to share it with you later on.

Moderator: Thank you, sir. We have next question from the line of Ranjit Cirumalla from B&K Securities. Please go ahead.

Ranjit Cirumalla: It was mentioned that the Company would look into benefitting from PLI schemes in Pharma and probably Chemicals as well; would this benefit be direct or indirect?

Rajendra Gogri: That will be indirect benefit and for some of it, we are looking at a possibility of developing it.

Ranjit Cirumalla: The Company would be taking 105 acres of land in Dahej; are there plans of taking a direct benefit at least in Pharma?

Rashesh Gogri: In Pharma, the products which are there in the PLI scheme are older products and are more commoditized. The Company is more into higher-value chemistry and higher-tech chemistry where it looks at enzymatic reactions and anti-cancer steroids. Looking at the current list, the Company would not be in that space.

Ranjit Cirumalla: The Company has been incurring CAPEX of over ~Rs. 1,000 crore and has guided for it to remain elevated for couple of years. Would setting up a subsidiary be considered as the tax benefits can be availed of?

Chetan Gandhi: There are lot of hidden clauses in that tax benefit and is not an easy thing. So, at least the CAPEX that the Company is doing as of now, would continue in the current tax structure.

Ranjit Cirumalla: On the interest – there have been ~Rs. 6 crore of gains due to which the interest cost is a bit lower this quarter. Would Rs. 28 crore, after adding back Rs. 6 crore be the normal run rate of the interest for the next couple of quarters?

Chetan Gandhi: Yes, it should largely be around that, plus or minus 5-10%. It is all provided; we look at the forward interest rate.

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

Rohit Nagraj: How much has been invested in the 105 acres of land?

Rashesh Gogri: We have not invested anything; just that the land has been acquired. From the land's cost perspective, the investment must have been close to Rs. 45-50 crores.

Rohit Nagraj: The number would be over Rs. 50 crore?

Chetan Gandhi: Around Rs. 50 crore.

Rohit Nagraj: On the cancelled long-term contracts – the compensation would be at US$ 5 million per quarter. However, if the company decides to source the material from you, then would that revenue be over and above the US$ 5 million or would it initially form part of the US$ 5 million?

Rajendra Gogri: No, as of now, they would not be consuming it as they have stopped their construction.

Rohit Nagraj: If they decide to come back to the Company for material, then would it be over and above the compensation amount; would it be a different revenue scheme altogether?

Rajendra Gogri: That will have to be separate if it is outside of this contract. There can be a totally new contract as well, where the material may not be going to their own plant for tolling. Thus, that is a completely separate idea.

Moderator: Thank you, sir. We have next question from the line of Pavas Pethia from Enam Asset Management. Please go ahead.

Pavas Pethia: Talking about the return to the long term trajectory of 15-20% PAT CAGR, what does FY22 look like? Would it be that from the base of FY20, there would be growth from ~15% to 35% or is it with FY21 as the base, which would be flattish, that the Company would grow 15-20% every year?

Rajendra Gogri: There is a 3-4-year period; next year, the Company would see strong double-digit growth. The exact guidance for FY22 would be clearer in Q4; subsequently, there would be further growth in FY23.

Pavas Pethia: To look at the next 4 years, would the base be of FY20 or FY21?

Rajendra Gogri: FY20 will be the base.

Pavas Pethia: Over the last few years, the Company has been in a CAPEX mode; the flip side being that its sales growth was slightly lacking. Thus, the CAPEX is in a way weighing on the return ratios which used to be over 20% and is now down to 15-16%. Thus, when this reverses, with an asset turnover of more than 1x; would the Company then be back to the high 20s return ratios?

Rajendra Gogri: Yes, the turnover will see an increase. Unfortunately, COVID-19 has impacted here and the contract also was impacted. Though, going forward, the topline will increase.

Pavas Pethia: What would be the potential sales or EBITDA at constant prices; for all the projects' CAPEX incurred?

Rajendra Gogri: Yes, a topline of Rs. 2,000 crore plus is what the Company is looking at additionally.

Pavas Pethia: Is this excluding the two long term projects or including?

Rajendra Gogri: It would be included.

Moderator: Thank you, sir. We have next question from the line of Sameer Dosani from Carnelian AMC. Please go ahead.

Sameer Dosani: What would be the current mix of discretionary and non-discretionary; in FY20, it was 60:40, correct?

Rajendra Gogri: Yes, in FY20, it was 60:40.

Sameer Dosani: What would be the number for H1?

Rajendra Gogri: Discretionary would be a little lower than that.

Sameer Dosani: Are the margins for discretionary higher or similar; what is the margin trajectory for that?

Rajendra Gogri: It will depend be on a product-to-product basis; as a basket, we do not have any specific working.

Moderator: Thank you, sir. We have next question from the line of Pratik Rangnekar from Credit Suisse. Please go ahead.

Pratik Rangnekar: Just a clarification on the Specialty Chemicals' margin – would it be that, for the new business that was taken to the non-regular markets, the Company had to match its prices with what was prevalent there due to which the spread on that contract is a little lower; however, in the regular market for discretionary products, the spread is still intact compared to what it was earlier?

Rajendra Gogri: No, there is pressure in the regular market as well, mostly because the demand is lesser. The non-regular market would see a much higher impact.

Pratik Rangnekar: On the Pharma margin – it was mentioned that there is a structural improvement in the margins; what would be the driver? What is the ASP increase in US$/Ton US$/Unit basis?

Rashesh Gogri: Nearing the full utilization of the current capacity, the Company has been focusing on regulated and higher margin markets on account of which, the overall margins showed improvement. Once the additional capacity is on-boarded, there would be topline growth, which would be faster and would eventually result in a percentage growth in the net EBIT. In the new capacities, the additional API block would be coming up and the additional intermediate block would be commissioned in this year and the next.

Pratik Rangnekar: Would there be a realization increase component here which would contribute?

Rashesh Gogri: Yes, there is a realization increase component here.

Pratik Rangnekar: Is it possible to quantify that?

Rashesh Gogri: There are over 40-50 products that are being made. It would be 40 products of API and 50-60 products in intermediates. Thus, it cannot be quantified however, there is an increase.

Pratik Rangnekar: On the Dicamba plant – it was mentioned that there is visibility on the clients that the Company can sell to. What would the strategy be; would it be similar to the strategy that was adopted in Q1 where in order to increase the volumes, a lower margin was accepted? How quickly can the capacity be filled up once commissioned?

Rajendra Gogri: Yes, now the entire dynamics will change. Accordingly, the pricing for the product would be done and the volume could be expected in FY23. There is a pipeline in the system for Dicamba in FY22. Thus, there would be some volume in FY22 and a significant volume would come through in FY23.

Moderator: Thank you, sir. We have next question from the line of Prasenjit Bhuiya from Ambit Capital. Please go ahead.

Ritesh Gupta: This is Ritesh from Ambit. In FY20 there was pressure because of the Nitric Acid unavailability and weakness globally in Autos and Agrochem; in FY21, there was in impact due to COVID-19. From FY20 and FY21, the Company would have incurred CAPEX of ~ Rs. 3,000 crore, a flat EBITDA and ~3-4% growth in Gross Profit. Has the base business been under pressure over the last 2 years from the realizations in FY19; have the realizations corrected and put pressure on the P&L? With a guidance of 15-20% considering FY20 to be the base, then why not take it as FY19 as the CAPEX of ~Rs. 3,000 crore was incurred since then?

Rajendra Gogri: Part of the CAPEX will be for the replacement CAPEX and sustainability related CAPEX. Due to the cancelled order, the visibility would be that there will be some margin if we are able to sell this product.

Ritesh Gupta: On Specialty Chemicals – in FY19, the EBIT was about Rs. 820 crores and the year might end much lower than that. If you could provide a sense on the CAPEX commissioned which is causing some challenges in the profitability. On the base business in FY19 – has it seen margin erosion over the last 2 years and would it recover in the next 2 years?

Rajendra Gogri: More volumes are getting cleared up and the additional benefit will go there.

Ritesh Gupta: Has there been any volume growth in your base business over the last 2 years, i.e., comparing FY21 with FY19?

Rajendra Gogri: In the second quarter itself there were substantially higher volumes. Unfortunately, the margins were lower because of the COVID-19 situation. Once the situation normalizes, then the margin benefit will come in from that.

Moderator: Thank you. We have next question from the line of Falguni Sanghvi from JP Morgan. Please go ahead.

Sagar: This is Sagar here. On the guidance for PAT – it was mentioned that the Company has a flattish guidance for FY21. Would this mean that in the second half, the business would increase by ~30% than the second half of the last year? What will drive this business as there will still be margin pressure as it will sequentially improve, but not yet be at the pre-COVID level.

Rajendra Gogri: In Q4 FY20, there was an impact of ~10 days because of the lockdown. Overall the volume is expected to grow and the market spread should also get better. Pharma is also showing good traction compared to the last year.

Sagar: All of this would still need to give a 25-30% YoY growth; would the flattish guidance still be achievable or is it optimistic?

Rajendra Gogri: It would be achievable; according to the internal budgeting, this is possible.

Sagar: On the cancelled long-term contract – there is a second phase of commissioning which will take place by the end of this year. In the first phase, would the capacity be kept idle or would it be used for something?

Rajendra Gogri: No, it is being utilized for other markets.

Sagar: Already?

Rajendra Gogri: Yes.

Sagar: What would be the utilization rate right now, for that plant?

Rajendra Gogri: It is relatively less, but should get ramped up from this quarter.

Sagar: Is it related to developing the same intermediate which was going to be produced?

Rajendra Gogri: There is some flexibility in the first phase and some other products can also be made.

Sagar: On Toluene – how much would that be of the overall Specialty Chemical pie?

Rajendra Gogri: In this quarter, the volumes were better and going forward we expect the Toluene volumes to go further up in the second half, as well as in the next year.

Sagar: Would that business be somewhere ~7-8% of the Specialty Chemicals' business already or would it be much lower?

Chetan Gandhi: It would start hitting those kind of numbers.

Moderator: Thank you. We have the last question from the line of Arun Prasath from Spark Capital. Please go ahead.

Arun Prasath: About the land parcel that has been acquired – on the Company's QIP document, it was stated that it will be buying land parcels in Gujarat. Is this related to that?

Rajendra Gogri: It is a different parcel.

Arun Prasath: So the Company has a land parcel in Jhagadia, the Vilayat Industrial Estate and now this land parcel has been acquired?

Rajendra Gogri: No, the 'Vilayat' contract is still pending.

Arun Prasath: What would be the breakup of the CWIP? Rs. 1,500 crore is on the balance sheet; could you please provide the break up and the projects that are part of this?

Rajendra Gogri: The second phase of Chlorination, the second phase of the first contract, the second contract, the NCB expansion that is going on and the Pharma expansion is going to get commissioned in the next 2-3 quarters. There will be substantial commissioning in second half and first half of the next year, across the board and substantial capitalization will take place.

Arun Prasath: What would be the status on the NCB expansion?

Rajendra Gogri: The first phase of the NCB expansion would be towards the end of this year and second phase will happen in the next year i.e., FY22.

Arun Prasath: How would the utilization be from the start; would it be high?

Rajendra Gogri: There would not be much increase in the utilization there.

Arun Prasath: The current capacity is ~90%; would it be maintained or would there be a dip when the new NCB expansion comes in?

Rajendra Gogri: There is enough demand on that. A lot of the material is currently imported; hence we would be able to utilize it immediately and increase capacity.

Moderator: Thank you, sir. Ladies and gentlemen, that was the last question. I would now like to hand the conference over to the management for closing comments. Over to you, sir.

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

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