Aarti Industries Limited
Q3 FY 2021 Earnings Conference Call Transcript
January 29, 2021

Moderator: Ladies and gentlemen, good day. And welcome to the Aarti Industries Limited Q3 FY 2021 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode. And there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal the operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Shiv Muttoo from CDR India. Thank you and over to you, sir.

Shiv Muttoo: Thank you, Lizann. Good evening, everyone. Thank you for joining us on Aarti Industries Q3 FY 2021 Earnings Conference Call. We have with us today on this call Mr. Rajendra Gogri – Chairman and Managing Director of the company, Mr. Rashesh Gogri – Vice Chairman and Managing Director, and Mr. Chetan Gandhi – CFO of the company.

Before we begin the call, I would like to point out that some 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 very warm welcome to all of you attending this call. I hope all of you and your families are in good health, and we look forward to the country emerging healthy out of the difficult situation related to the virus pandemic. I trust that all of you would have received the Q3 FY 2021 results presentation that has been uploaded on the stock exchange website earlier today.

Our financial performance in Q3 showed continued improvement, which is in line with our expectation. And the outlook forecasts a stronger turnaround in the second half of the financial year that was previously shared with all of you. The sustained strong momentum on both operating and financial parameters during the third quarter based on the improving visibility.

During Q3, we reported revenue of Rs. 1,311 crore, which was higher by 7.6% Y-o-Y, driven by turnaround in demand for our regular markets and established relationships. We also recorded our highest ever quarterly EBITDA, PBT and PAT for the company. As indicated earlier, we remain well positioned to meet our guidance of delivering profits in line with last year, despite the exceptional disruptions seen for the large part of FY 2021.

The quarter saw the continued recovery phase with gross income from operation of the company on a standalone basis at Rs. 1,261 crore, EBITDA at Rs. 269 crore and

PBT of Rs. 199 crore, and PAT of Rs. 162 crore. While on the consolidated basis the gross income was Rs. 1,311 crore for Q3 FY 2021, about 8% higher as compared to the Rs. 1,218 crore for Q3 FY 2020. During the quarter we witnessed the improvement in margin of 90 basis points and EBITDA expanded to 12% Y-o-Y to Rs. 285 crore as compared to Rs. 254 crore a year back. The rebound on this parameter over the last two quarters after the weakness in Q1 reflects the resilience in our business model and the encouraging improvement in the dynamics of our business.

Finance charges reduced based on the lower cost of funds and the forex linked revaluation gains on the long-term borrowing. Profit before tax increased by 17% to Rs. 209 crore and profit after tax by 18% to Rs. 169 crore during Q3 FY 2021.

CAPEX for the quarter was Rs. 365 crore, which took the aggregate nine months to Rs. 891 crore, we are well positioned to meet our indicative CAPEX guidance of Rs. 1,000 crore to Rs. 1,200 crore for FY 2021. Following the commercialization of our new chlorination facility at Jhagadia, we continue to take forward several other CAPEX programs. Some of these projects that are drawing closer to launch as our expansion momentum remains intact. Next in line are projects related to long-term contracts, NCB expansion, pharma expansion, etc. that are slated to be commissioned over the next few quarters, providing the planned growth acceleration next year.

Meanwhile, our R&D facility in New Bombay, which was operationalized just before the country went into lockdown, is now running at near full operating capacity. Here we are developing new products, new chemistry and new technologies that will contribute to our roadmap of expanded growth visibility over the next few years.

Speciality Chemical business in Q3 was driven by gaining momentum across various end user market, representing further improvement over Q2. Speciality Chemical segment reported consolidated segment revenue of Rs. 1,079 crore, witnessing a growth of about 4% as compared to the revenue for Rs. 1,042 crore in Q3 FY 2020. The consolidated EBIT also grew by 4% Y-o-Y and was Rs. 224 crore for Q3 FY 2021, whereby generating EBIT margin of 20.7%, as compared to EBIT of Rs. 215 crore for Q3 FY 2020, which was at a similar margin. With this performance, Q3 FY 2021 also recorded the highest ever EBIT for the Speciality Chemical segment, we are seeing returning demand from established market driving improved margins after H1. And we had seen higher exploratory sales to discretionary spend in market as our objective had been on expanding volumes and rationalizing inventory during a tough operating environment. Contribution to segment revenues from value added product increased from 72% to 76%. Strategically, our focus remains on increasing the contribution from value added chemistry within our portfolio, gaining prominence within the development programs of the large number of global innovators.

Now, for the Q3 production upgrade, there has been a higher scale in production following reduction in lockdown restriction and volumes have been expanding. Production of Nitro Chloro Benzene was at 16,830 metric tonnes compared to 14,900 metric tonnes a year back. Similarly, for hydrogenated products we have achieved production of 2,740 metric tonnes compared to 2,330 metric tonnes last year. On the Nitro Toulene front, production for Q3 was 3,600 metric tonnes compared to 1,667 metric tonnes in the same quarter last year. We expect to deliver steady performance improvement going forward, separate by a new facility coming online, as discussed earlier.

Our Pharma business continued to deliver growth in revenue with positive operating leverage on increasing volumes. Segment revenue grew by 32% Y-o-Y during Q3 to Rs. 232 crore as compared to Rs. 176 crore for last Q3, which is the highest ever top line achieved historically by the pharma business. Based on the higher utilization, continued throughput from our regulated market and higher contribution from value added products and a growing pipeline of new introduction segment margin seeing structural improvement. In Q3, EBITDA expanded by 53% to Rs. 55 crore as compared to Rs. 36 crore for Q3 FY 2020.

Pharma revenue growth is expected to sustain as additional capacity for AP and intermediates are operationalized. We are also seeing the benefits from India's improving position in global value chain. Going forward, we will continue to drive deeper penetration in therapies such as Antihypertensive, Cardiovascular, Oncology, Corticosteroids etc. We have a strong pipeline of approval and visibility to maintain our growth. Over the years, the pharma segment has grown to a substantial scale and size, having significant further growth opportunity. As a part of the long-term growth opportunity and business strategy, the Board felt the need to evaluate the feasibility for demerger of pharma and allied activities, hence a committee has been constituted to evaluate the same.

To conclude, we are making a strong operating progress with every component of the business delivering very positive traction. Going forward, our strategic focus will be on creating a sustainable growth framework as we align with India's growing position as a preferred partner of choice to global supply chain, with scalable capabilities. We have made commensurate investment to participate in such opportunities, backed by our initiative in R&D, sustainability and other internal competency, in line with the global best practices.

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

Moderator: Thank you. Ladies and gentlemen, we will now begin with the question-and-answer session. First question is in the line of Anshuman Atri from Premji Invest. Please go ahead.

Anshuman Atri: My question is regarding the demerger. We have seen one demerger on the Surfactants business and now under evaluation is Pharmaceutical. So, suppose for example, in future we have these PLI schemes coming up on pharma and speciality, so how will the company try and ensure that the respective demand is catered by specific companies? And is it not better to scale one company rather than have multiple companies listed on the exchange?

Rajendra Gogri: Yes. Our pharma business has been growing over the last few years. We were about, I think, Rs. 112 crore EBIT about three years back. Now we are reaching about Rs. 200 crore EBIT from the scale point of view. And the manufacturing sites and the market is quite different from Speciality Chemical, so that is the reason we are trying to evaluate and take an overall view, whether it will be better than if we remerge with the capacity or whether it should be a consolidated company. And the point you made also is quite valid in that sense. So, we will take into account that factor also when we evaluate the various points.

Anshuman Atri: And sir, the second question is regarding, we have few sister companies like Aarti Drugs is there, do we plan to have one single pharma company where all associated companies of the Aarti Group….

Rajendra Gogri: That is a possibility which can happen in a longer term, but not in any immediate term, we are not going to have this. If this demerger is decided, then it will get a separately listed company. And then going forward, both companies may merge based on the situations and synergies then, I don't know. But that is maybe on a much longer horizon.

Moderator: Thank you. We will move on to the next question that is in the line of Rohit Nagaraj from Sunidhi Securities. Please go ahead.

Rohit Nagaraj: Congrats on good set of numbers. Sir, the first question is in terms of, weather we have started supplying any material from the cancelled long-term contracts to any of our customers? So, just wanted to know, yes, we have received the 5 million payment, but are we producing any material from there and supplying it to the same customer or other customers? Thank you.

Rajendra Gogri: This plant has been taken up for commissioning in Q4 of this year.

Rohit Nagaraj: Okay. So it has not yet commissioned, is that what the understanding is?

Rajendra Gogri: Yes, we are going to start commissioning in February.

Rohit Nagaraj: Okay. So have we received any new orders, after the commissioning is done, to produce any product from this particular facility? Or do we have any plans for the same?

Rajendra Gogri: No, there is some other market for this also. So initially we will commission the product and put it into the other market. And we will see how that thing moves as far as dicamba is concerned.

Rohit Nagaraj: Right. Sir, second question in terms of the exports market. So, recently we have seen the container availability issue, as well as the freight rates have gone up. So have they impacted by any chance in the Q3 revenues and what do we foresee in terms of our Q4 revenues from exports? Thank you.

Rajendra Gogri: Yes, the container availability is an issue, but till now our dispatch has not been impacted. But definitely some of the area there are issues in that sense.

Rohit Nagaraj: And till now, in fourth quarter is there any impact?

Rajendra Gogri: Not yet I don't see. I think we should be able to manage, because we are very large exporter, and we have a very good relations with shipping lines. So overall, we don't see that there will be any volume impact.

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

Naushad Chaudhary: In the initial remarks we mentioned, in Speciality Chemicals some of the end user industries are doing well for us. If you can name those end user industries which area specifically is driving more growth for us?

Rajendra Gogri: Yes, basically this domestic market end use has virtually recovered to pre-COVID level. In export now we are seeing increase in textile segment, and some traction in the engineering polymer side also and automobiles also.

Naushad Chaudhary: Okay. Secondly, in terms of Chemicals margins, if I see our overall spread, it is still in pressure and we have seen some quarter-on-quarter improvement in our Speciality Chemicals margin. So, are there any specific reason for this margin improvement or its just because of the operating leverage we have seen this?

Rajendra Gogri: No, as we had mentioned in our Q2, we sold a lot of products in the non-regular market and also make products which are a little less margin because of the less demand in our regular discretionary market. So, now the margins what we have seen are much more on a normal level as compared to what was there in the previous quarter.

Naushad Chaudhary: Okay. So, if the spreads improve from this current level, the margin should go up further from the current reported number or should it be in a similar range?

Rajendra Gogri: Overall, the utilization will increase, and the margin will increase because of that. But as some other new plants are going to be commercialized, when they come in, thay will have a rampup phase and hence normal margins for that may take a little more time. So, you can say this is level it should remain.

Naushad Chaudhary: Okay. And lastly on the data points, if you can share PDA volume of this quarter versus last year same quarter.

Chetan Gandhi: PDA this quarter was 520 tonnes per month. While last year it was at 420 tonnes. So, there's a 100 tonnes per month increase in PDA.

Moderator: Thank you. The next question is from the line of Amar Maurya from Alpha Accurate Advisors. Please go ahead.

Amar Maurya: My first question is, with reference to both Speciality Chemical and Pharmaceutical segment, if you can broadly give both segment-wise the capital expenditure for FY 2022 and FY 2023? And how do you see the growth outlook for both these segments, along with profitability?

Rajendra Gogri: You wanted the capital expenditure for next two years, that's what you are saying?

Amar Maurya: Yes, capital expenditure for FY 2022 and for FY 2023 for both Speciality Chemicals and for Pharmaceutical segment.

Rajendra Gogri: Overall, Speciality Chemicals, we are moving around Rs. 1,000 crore, I mean, Rs. 800 crore to Rs. 1,000 crore. And Pharmaceutical around Rs. 150 crore to Rs. 200 crore. But we are not yet totally frozen. So, the annual capex is generally broadly around Rs. 1,000 crore to Rs. 1,200 crore, with around 20%-25% going in pharma and around 80% in Chemicals, that's a broad situation.

Amar Maurya: And can you give, basically this CAPEX is for what kind of products, backward integration, how do you see the breakup of this expenditure?

Rajendra Gogri: Yes, we have planned for some of our regular current benzene chain also we are adding a new downstream product. And entire Chloro Toluene chain is new one, that will be the adding new products to the portfolio. So those will be our major Speciality Chemicals CAPEX for next two to three years. The Chloro Toluene chain and furthermore the downstream products and some debottlenecking of our existing benzene and Toluene line.

Amar Maurya: For Pharmaceutical?

Rajendra Gogri: We are basically going to install a new intermediate facility in Dahej, for which we have already acquired the land. So, that will be taken up in next couple of years. And we have ongoing expansion of our API site also, for which we have received the EC in this current quarter.

Amar Maurya: I see. Sir, why am I asking this question is that as you are planning to demerge both businesses separately, I was just trying to understand that Pharma business which is currently roughly about 17% of the revenue, how do you see the Pharma business over the next three, four or five years?

Chetan Gandhi: Pharma business in general, it has been growing, last five years it has given a CAGR of 18%. And I think we are hopeful that it will go at 18% to 20% top-line going forward. And in terms of bottom-line, last five years EBIT has grown 37%, of course, we can't sustain 37%, but overall, I think we are looking at 20-25% kind of growth.

Amar Maurya: Okay. Just last question from my side. Sir, whether these both businesses have any, what I would say, transfer pricing division wise or a synergy which probably once you do demerge that basically will reduce, how do you see that what is the rationale for demerger?

Chetan Gandhi: To answer your question, there are no integration or interlinkages between the Chemicals and Pharma.

Amar Maurya: I see. So, what is the major rationale for demerger?

Rajendra Gogri: Yes. Basically, now there is a good phase for Pharma and good growth opportunity. So we are just looking at that possibility whether there can be a two-pronged growing something.

Moderator: Thank you. The next question is from the line of Sangeeta Purushottam from Cogito Advisors. Please go ahead.

Andrey Purushottam: I am her husband and partner, Andre Purushottam here. First of all, congratulations for a good set of numbers. My question is a bit of a long-term strategic one. Given the background that you have been fairly intensely indulging in CAPEX, as an investment for growth, in a three-to-five-year horizon how do you see your CAPEX strategy panning out? Is there some period of time in the future when you see this amount in CAPEX tapering off? Or you see sustained base of CAPEX over three-to-five-year horizon that we are talking about?

Rajendra Gogri: Now, there is a huge appetite from India and also because of government Atmanirbhar Bharat scheme, we expect that overall chemical manufacturing in India, for both intermediate and downstream chemicals, will increase. So, we see that at least for next four to six years we should be able to maintain this kind of a CAPEX, that kind of opportunity should be available and specially because we are very wide end use exposure from agro to pharma to dyes, pigments, engineering polymers and also, we have an opportunity to expand in various end use segments. At least for next five, six years I see that we will be still in an investment mode.

Andrey Purushottam: So the CAPEX would be of what order of magnitude every year, would it be about Rs. 300 crore, Rs. 400 crore, Rs. 500 crore roughly?

Rajendra Gogri: No, Rs. 1,000 crore level is what we expect to be there for next at least four, five years for sure.

Andrey Purushottam: Rs. 1,000 crore per year?

Rajendra Gogri: Yes.

Moderator: Thank you. The next question is from the line of Aditya Khetan from East India Securities. Please go ahead.

Aditya Khetan: Sir, my first question is that the discretionary sector pickup has been quite slow, and that is visible from your sequential revenue numbers which grew only marginally. I believe you were expecting a good pickup in the second half, but still the growth from the discretionary seems to be laggard. So, what could be the major reason for the same? And how are you expecting on sequential numbers for Q4?

Rajendra Gogri: Basically, this last quarter it was more we had to go on for transferring from some non-regular market, so we could get it back to our regular market. So, the top-line increase is not much, but the margins have expanded. And going forward, I think, by end of fourth quarter I think discretionary spending it should reach to almost pre-COVID level for export market also.

Aditya Khetan: Okay. Then sir, second question, you have mentioned that now we are exploring a new segment, that is Chloro Toluene. So I just want to know what is the opportunity sizes? I mean, how big is the market and what is the potential Aarti can take in that?

Rajendra Gogri: Yes. Overall, we see more than Rs. 1,000-plus crore definite revenue, maybe more than that. Because nobody's making those range of products in India yet. And we see a sizeable possibility there, Rs. 1,000 crore plus top-line.

Aditya Khetan: Okay. So this Chloro Toluene is completely an import substitute product or like there are domestic manufacturers for the same?

Rajendra Gogri: No, it is a total import substitute. So we will be making Chloro Toluene as well as some of the downstream which are also imported into India. We shall also have opportunity to export the same from India to other geographies, as there is no current Indian source

Aditya Khetan: Okay. And sir, my third question is around the PDA utilization. If we look for the last two years, so the utilization has been almost constant at around 45% to 50%. In this quarter, we have seen around 100 tonnes per month improvement in the PDA volumes. So, what has changed now? And for the last two years what was not changing? I just want to understand that.

Rajendra Gogri: Now we see that in some of the other market also we should be able to penetrate and volumes going forward should expand in PDA.

Aditya Khetan: Okay. So, what are the end use segment for the PDA?

Rajendra Gogri: PDA is mainly on dyestuff and engineering polymers; these are the two major segments.

Aditya Khetan: Okay. And sir my last question, what is the CAPEX outline for particularly NCB expansion? And are we on track to complete by FY 2022?

Rajendra Gogri: Yes, that is about Rs. 150 crore.

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

Nav Bharadwaj: Sir, could you please share your volumes this quarter for nitric chloro benzene? And shed some light on the pricing as well.

Chetan Gandhi: So the Nitro chloro benzene volumes in this quarter was 16,830 tonnes.

Nav Bharadwaj: So similar to last quarter. And anything on the pricing?

Chetan Gandhi: Pricing won't be possible; it won't be possible for us to share.

Nav Bharadwaj: No worries. Sir, also on the CAPEX front, if I rightly understand, cumulative with the CWIP and the CAPEX that is going on, we have roughly Rs. 2,400 crore of new capacity coming out. How much of that can be attributed to the Pharmaceutical business and how much is for the Speciality Chemicals business?

Chetan Gandhi: So, close to more than Rs. 200 crore to Rs. 250 crore would be related to the pharmaceutical aspect.

Nav Bharadwaj: Let's say just 10% of the whole kitty right now?

Chetan Gandhi: Because they have something which has already been done, so that's why.

Moderator: Thank you. The next question is from the line of Karan Rathod from AUM Advisors. Please go ahead.

Karan Rathod: Sir, just wanted to check. Your current gross block is about Rs. 2,750 crore, I am guessing most of it is Speciality Chemicals and you are on a Rs. 4,000 crore revenue run rate. And if I look at your capital work in progress as of September, it was Rs. 1,500 crore, Rs. 1,600 crore, you will add another Rs. 600 crore by the end of March, per year Rs. 1,200 crore guidance, and another Rs. 1,200 crore next year. So then you will become almost Rs. 3,500 crore of capital work in progress. I mean, should we look at asset turnover from a Rs. 3,400 crore fresh capitalization or increase in EBIT margins beyond the current 20% margins? How are you looking at it? This question is more sort of what sort of sales growth are you seeing, or margin expansion are you seeing as a result of this massive CAPEX over the last one year and possibly over the next few years?

Rajendra Gogri: Yes. We see that around Rs. 2,000 crore to Rs. 2,500 crore top-line coming out of this CAPEX, current WIP and some more which will be going on. And I think Rs. 400 crore to Rs. 600 core level of EBITDA it should be able to generate out of that, incremental.

Karan Rathod: So sir, that will be then a little lower margin than what you are currently doing. Currently you are doing Rs. 4,000 crore revenue and you are doing 20% EBITDA, about Rs. 750 crore of EBIT. And with the incremental CAPEX of Rs. 3,400 crore you will have a whole turnover from that we will sort of not compromise your return on capital, the incremental return on capital.

Rajendra Gogri: No, still something will go in capital WIP also. So, there will be always some capital WIP in that sense.

Moderator: Thank you. The next question is from the line of Kunal Mehta from Vallum Capital. Please go ahead.

Kunal Mehta: Sir, my questions have been answered. Thank you for the opportunity.

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

Moderator: Ladies and gentlemen, we seem to have lost the audio from the line of the current participant. We will move on to the next question, that is from the line of Rohan Gupta from Edelweiss. Please go ahead.

Rohan Gupta: Sir, a couple of questions on my side. Sir, first is just an extension of the previous question. You mentioned that roughly with the cumulative CAPEX of roughly Rs. 2,400 crore, we are expecting revenues of Rs. 2,200 crore to Rs. 2,500 crore, generating an EBITDA of Rs. 600 crore. Sir, probably this is first time in the history of the company that we are going to see such increase in gross block, almost Rs. 2,400 CAPEX in FY 2020, in FY 2021 is going to converted in a capacity or real revenues in FY 2022, and probably in FY 2023. Sir, generally we have a time lag of almost 18 months, so do you see that there are any hindrances in converting these CAPEX into revenues in FY 2022 and 2023? Or it is going to take longer with a lag of more revenues flowing in 2024 or something?

Rajendra Gogri: It will be more on FY 2022 and 2023, and 2023 and 2024. So FY 2023 and FY 2024, that is arranged by this time to get this kind of a top-line.

Rohan Gupta: So you see that there are enough demand and enough projects in hand to consume all these CAPEX and can we see that the utilization level for these incremental CAPEX is going to be significantly consumed over the next two to three years? Because we are still seeing that our top-line growth from last one year to one and a half year has been significantly impacted, despite we are continually doing CAPEX. So, are we getting into a timeframe where most of these CAPEX of last two years is going to get converted in revenue? So that's what I just wanted to reconfirm, sir, we have enough projects in our hand and there is enough growth visibility that this CAPEX won't be compromised with its overutilization.

Rajendra Gogri: Now there is enough visibility on the top-line growth next two to three years for sure.

Rohan Gupta: Thank you. Sir, second question is on our strategy of demerging our pharma business, sir I know and I recall our con-call almost two years back when you had given this suggestion of demerging your Pharma and the Surfactant business separately. At that time, I think investors was only behind you of demerging these businesses which was generating lower capital, lower ROCE. Sir, but now that the business and pharma business is doing pretty well and there is enough growth opportunity, you already have a separate company under Aarti Drugs of pharma business, almost in similar line what you are doing right now.

Sir, if we see that some of the companies who are in agrochemicals, they are struggling to get into pharma businesses, because only being in agrochemicals probably may not give us enough growth opportunity. Sir, you are probably or Aarti Industries right now in a current scenario is fortunate enough to already have its presence in pharma. Sir, it would not be prudent now that you keep this business under this company only and take the benefit of integrated business model between agro chemicals and pharma API's and pharma other specialty chemicals keeping in the same business under the same roof under Aarti Industries?

Rajendra Gogri: Yes, these are some of the factors which we will take into account once we do this new evaluation. This definitely reduces our diversified end use which currently we have, that diversification reduces if you remove the pharma out of it. So, from that point of view, it is a disadvantage.

Rohan Gupta: No, sir, I was talking about the synergies and the similarities which are there in agro chemicals and pharma API's and pharma specialty. So, why not take the advantage of that, the same integrated business model, because some of ag chem companies are trying to get into pharma, but they are struggling. And when we already have that business and when we are trying to demerge that. So, I just wanted to have a more clarity that why that we don't have a similarity between both of the businesses. You said that both pharma and agrochemicals are completely separate, I just want you to elaborate a little bit more than how these two businesses operate.

Rajendra Gogri: Yes, this is totally different end use, customer base is totally different and our manufacturing sites, scale, the prices of the product, volumes are quite low- and high-priced products in pharma. So manufacturing activity is quite different compared to our intermediate and even agro chemicals, which are more on higher volume and a relatively lesser price compared to pharma.

Rohan Gupta: Okay. And sir just to reconfirm and I will get back into queue again, just to reconfirm, you mentioned that pharma business offered 18% to 20% revenue CAGR over the next four to five years while PAT can grow at 25%, despite we already have very solid EBIT margins in the current year in pharma business which is roughly 23% to 24%. Despite that, you see that PAT growth in pharma business over next four to five years can be 25%.

Rajendra Gogri: Yes, yes.

Moderator: Thank you. The next question is from the line of Ashutosh Garud from Ocean Dial. Please go ahead.

Ashutosh Garud: Sir, the CAPEX plan which you just mentioned, around Rs. 1,000 crore kind of a CAPEX on a per annum basis for the next four or five years. So, do you mean to say you would be like more than doubling your gross block in next four odd years? And if that is so, then what kind of five, six years of revenue CAGR do you see? Because we have already incurred CAPEX earlier also and as a as a company what kind of growth you are expecting from FY 2022 onwards, let's say, not from FY 2023 but even in FY 2022 onwards what kind of a run rate are we expecting? Because last three-odd years have been flattish from top-line perspective.

Chetan Gandhi: The current CAPEX, which is there, should be good enough for us. I mean, we have already given a guidance that we should be able to maintain our growth of around 15% to 20% over the next three to four years, so the current CAPEX trend and other stuff, we should fairly be able to justify, I mean, stick with that growth guidance. As regards the future CAPEX, which is going to come in two years, three years down the line, we still have to do some numbers working and evaluate in terms of what is the kind of growth numbers which will come out from that. It will be a bit early for us to take a view beyond four years at this point of time. But having said this, generally, all the CAPEX initiatives, which we broadly take up, wouldn't have a ROCE of about 20%. So with that rationale, I believe we will continue to maintain a healthy growth profile.

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

Harsh Bhatia: Sir, given that large nitro chloro benzene capacity has been shut down in China,let's say, almost 40%, which would consequently restrict the NCB output as well, within China itself. Is there any sort of directional impact are we seeing in our pricing for nitro chloro benzene, PNCB, ONCB? That's my first question.

Rashesh Gogri: Yes, there is an impact on the nitro chloro benzene pricing, as you rightly said. And we are getting advantages in overall pricing and margins in this product line.

Harsh Bhatia: What will be the proportion of the China's revenue in this quarter? Given that last quarter it was 20%, which was kind of high as compared to the normal single-digit, anything on that front?

Rashesh Gogri: Yes, overall I think, Chetan, you have the number of China exports?

Chetan Gandhi: So, China export in Q2, we've seen it going to a level of 20% more in terms of sending the material to the non-regulated market, and this quarter it has normalized to around 11% to 12%.

Rashesh Gogri: Yes, it has come down. And we have not exported marginal products to China this quarter, because the demand in India has come back.

Harsh Bhatia: That makes sense. One final question from my end would be, if there is a possibility you could provide a state of PNCB, ONCB, I think it's not captivity consumed. Are we providing it to domestic players or are we exporting it directly?

Rashesh Gogri: No, PNCB & ONCB, we are not exporting significantly. So it is largely consumed in India, 90% to 95% is consumed in India.

Moderator: We will move on to the next question, that is from the line of Naushad Chaudhary from Systematix. Please go ahead.

Naushad Chaudhary: Sir, what is the gross debt we have as of this quarter and how much of that would be for pharma business?

Chetan Gandhi: We don't have a separate bifurcation on debt between pharma and chemical. The gross debt what we have is roughly around Rs. 2,500 crore.

Moderator: Thank you. We will move on to the next question, that is on the line of Pavan from Renaissance. Please go ahead.

Pavan: Sir, just one question. Sir, given our plans to do Rs. 1,200 CAPEX on an annual basis, unlikely we will be generating free cash at least for next two, three years. So one thought on this free cash, and secondly, what is the peak debt equity or debt EBITDA levels that you are comfortable with?

Chetan Gandhi: Debt equity around 0.7 to 0.9 is our internal view on that.

Pavan: And on the free cash flow side it is fair to assume that we won't be generating free cash, at least for next three, four years?

Rajendra Gogri: I think in a chemical industry we are really in a sweet spot as far as the demand is concerned. And I think this is the right time for an investment for next few years for sure.

Pavan: Okay. And one more thing, I missed your comment that you mentioned about Rs. 600-odd crore of additional EBITDA, so that you were referring to the CAPEX that you have undergone in the current year, is that the case?

Rajendra Gogri: Current year and part of next year also will come into that.

Pavan: Okay. And it was also mentioned that we are looking at 20% ROCEs for our CAPEX. So, simple math behind that would be like what are the assets we are expecting generally then?

Rajendra Gogri: Asset turnover would depend on the value addition, but typical asset turnover would be between I think 1 to 1.5.

Moderator: Thank you. The next question is from the line of Amar Maurya from Alpha Accurate Advisors. Please go ahead.

Amar Maurya: Just a few clarification I was looking for. You mentioned that our current capital work in progress is roughly Rs. 1,400 crore, my first question is, when this capital work in progress will convert into gross block? That is my first question. My second question is you mentioned Rs. 1,000 crore CAPEX in chemical and roughly Rs. 200 crore in pharma. I assume that is over and above the current capital work in progress to be spent over a FY 2022 and FY 23. Kindly clarify on the same.

Rajendra Gogri: Yes, that is more over and above capital that we have seen. And substantial of this capital WIP will get commissioned in Q4. Additional CAPEX will add on the WIP.

Amar Maurya: I see. And of this Rs. 1,400 crore, how much is for chemical and how much is for pharma?

Rajendra Gogri: It would be 90:10 or something, I mean.

Amar Maurya: 90% Speciality Chemical and 10% pharma?

Rajendra Gogri: Yes, approx.

Amar Maurya: Okay. So, now basically given that almost around out of the Rs. 1,400 crore we are going to spend 90% in the Speciality Chemical and Rs. 1,200 crore, so 80% in the Speciality Chemical. So, basically wanted to understand if I see your current gross blog, which is around Rs. 3,800 crore and another Rs. 2,400 crore, Rs. 2,500 crore will be added, so in that context like when we say 25% ROCE on 1.2x times or 1.5x asset ratio, are we saying that these all products will be a high margin business than the current business margin? Because currently we are not making 25% ROCE.

Rajendra Gogri: Yes, our idea will be to get more and more on value added products. So we expect our margins to be higher.

Amar Maurya: Got that. And sir, this Rs. 1,400 crore of capital work in progress, when it will be commissioned, when it will be added to the gross block?

Rajendra Gogri: I think 50% should be in Q4 more or less.

Amar Maurya: 50% will be in Q4, okay. This is basically in Q4 largely that dedicated capacity CAPEX, right?

Rajendra Gogri: Yes. So, a major chunk will be that.

Amar Maurya: A major chunk would be that. So, sir, my question is to understand that dedicated CAPEX still, I mean, we did not get any customer, I mean, no visibility from the scale perspective. So, should we assume that that scale will take more time to percolate into the revenue?

Rajendra Gogri: Yes, that’s why we are seeing a little more, FY 2024 will be the more by that time the turnover materializing will happen, it is not going to happen in 2022, it will be more in FY 2023 and FY 2024, because 2022 next year we don't expect too much sales out of that CAPEX,

Amar Maurya: Correct. And the remaining CAPEX out of that Rs. 1,400 crore, approximately Rs. 700 crore, that will come in which year?

Rajendra Gogri: That will be capitalized next year.

Amar Maurya: So, FY 2022?

Rajendra Gogri: Yes.

Amar Maurya: First quarter or second quarter?

Rajendra Gogri: It will over a period of time. Substantial will happen in first half.

Amar Maurya: And that would be largely, I am assuming that that would be the market facing kind of a CAPEX where we have a higher visibility of the revenue?

Rajendra Gogri: Sure, yes.

Amar Maurya: And that would be like what you are saying, 20% kind of ROCE business?

Rajendra Gogri: Yes.

Amar Maurya: Right. And sir, remaining this Rs. 1,000 crore CAPEX, that will be commissioned in 2023 and 2024, correct?

Rajendra Gogri: Yes, then it will be going in subsequent years.

Amar Maurya: And how much would be the maintenance CAPEX out of this Rs. 1,000 crore?

Rajendra Gogri: Current maintenance CAPEX is around Rs. 300 crore.

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

Rohit Nagaraj: Sir, just on the CAPEX part. So, the 20 year contract, that particular commissioning will happen in second half of FY 2022, is that correct?

Rajendra Gogri: First half of 2022.

Rohit Nagaraj: First half of FY 2022?

Rajendra Gogri: Yes.

Rohit Nagaraj: Okay. And the $125 million 10-year contract, it was supposed to be commissioned in Q4 FY 2021, so are we on track for commissioning that?

Rajendra Gogri: No, that we have already mentioned that that is also delayed because of the COVID side, here also and in customer end also, that will be second half of FY 2022.

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

Arun Prasad: Sir, my question is on the extent of opportunity available in the import substitution side, which is kind of a low hanging fruit for you. So, if I take your current top-line, it is about Rs. 5,000 crore; roughly Rs. 2,500 crore would be in the domestic Rs. 2,500 crore to Rs. 2,600 crore. So, how this number would be looking like, say, in coming months? Is there a large import substitution opportunity still available or most of it is already exhausted? That is my question number one. I will subsequently ask the second question, if you can answer this.

Rajendra Gogri: In India, currently $45 billion chemicals are imported.

Arun Prasad: But if you again slice and dice into the segments in which you operate, what would be that number actually? So it won't be $45 billion entirely available to you, right?

Rajendra Gogri: I know. What I am trying to say that overall pie is very large, $45 billion. So, even $1 billion from that is definitely a possibility which you can look at. And then, again, the Indian economy going to grow, so left to itself is $45 billion, if nobody puts a plant then $45 billion is going to become $65 billion, $70 billion by the time in 2030. So, overall, the import substitution itself is like a $1 billion opportunity can be there in next 10 years for sure. Because we are a very end-use agnostic product line, so we can expand into various end use as a feeder to various sub segments.

Arun Prasad: Sir, what I was asking is, $1 billion could be the future number, but currently what is that which is still untapped by the company? Is it still $1 billion or it would be a different number?

Rajendra Gogri: Overall we have identified up to $1 billion, if I can say. Those kind of possibilities are there. The only thing is it will take time, you cannot do that much at a shot. But those are the possibilities.

Arun Prasad: Usually what are the challenges? You have a significant opportunity in import substitution, you have existing customers who are currently importing, so you know the customers, so where is the challenge, is it the quality or is it the pricing or is it the distance between your plant and the customer plant? So, what are the challenges in exploring this opportunity aggressively?

Rajendra Gogri: R&D and putting up the plants. So basically you have to do the research and put up the plant. That is the entire activity, if you want to put up a dedicated site, from research to plant commissioning will take two to two and a half years. And if you are in an existing site, it will take maybe a year or so. So, the time lag is bound to be there on that side.

Arun Prasad: Thank you. My second question is on, we have been talking about the product projects like Photo Chlorination, Oxidation and Chloro Toluene. So, have you completed the basic engineering and the initial environmental clearance, all those is done or still is in progress?

Rajendra Gogri: We have already applied for environmental clearances.

Arun Prasad: And your basic engineering and design, all is completed? It is just waiting for execution or is there anything we are waiting for the market evolve or is there something that you are waiting for, any colour on that?

Rajendra Gogri: They are in different stages, certain are on basic engineering level, certain are on pilot scale. But demand-wise that is not an issue. So once we get there, we expect to start construction in post monsoon next year, next six months all the constructions should start for various plants.

Moderator: Thank you. The next question is from the line of Archit from Dolat Capital. Please go ahead.

Archit: Congrats for a good set of numbers. I just had one question on the bookkeeping side. So just the way you are accruing approximately $5 million per quarter from the first long-term contract, how will be the accounting treatment spread across all four quarters in FY 2022? Will it be like $15 million, $20 million per quarter or would it like a bullet treatment at the end of the year?

Chetan Gandhi: It will be a similar treatment for the quarter.

Rashesh Gogri: And in quantum sir, if we can have that number, approximately a ballpark number.

Chetan Gandhi: It will be difficult for me to come on to the number at this point of time but will be broadly in this range only.

Archit: Okay. $15 million to $20 million, somewhere between that?

Chetan Gandhi: Yes.

Moderator: Thank you. Next question is from the line of Abhishek Datta from Prabhudas Lilladher. Please go ahead.

Abhishek Datta: Sir, just wanted to check, you mentioned that the discretionary demand in the domestic market is largely back to pre-COVID levels and in the export market you are expecting it to recover by Q4 levels. So can we expect that the pain which was there in the first half is largely over and what kind of growth rate can we expect in this 40%, which is a discretionary demand in our portfolio?

Rajendra Gogri: Yes, so next year we will see a substantial growth in that segment in both margin as well as top-line next year.

Abhishek Datta: Okay. And sir secondly, you mentioned that you are expanding capacity on the Toluene side, isn't it that the Deepak Nitrite is also expanding capacity there?

Rajendra Gogri: No, I am talking Chloro Toluene.

Abhishek Datta: So in that space there is no one else who is entering the market?

Rajendra Gogri: No, it's not made in India currently.

Abhishek Datta: Okay. And sir, just wanted to recheck once again, like in next year you are suggesting that Speciality Chemicals revenue should be in what range largely?

Rajendra Gogri: So that we are still budgeting, so that I think we will give after our Q4 more definitive guidance for the next year.

Abhishek Datta: Because this year largely the run rate should be around Rs. 3,800 crore, Rs. 3,900 crore. So next year what kind of number which we should work with?

Rajendra Gogri: There will be definitely 15% to 20% minimum jump, but the more definitely we will be able to give post Q4. But you can count 15% to 20% jump for sure.

Abhishek Datta: And sir, just wanted to recheck, like this quarter you also benefited from low cost inventory or even though you work on cost plus business, but will you have benefited from low cost inventory in this quarter?

Rajendra Gogri: Not much, I think this quarter also the price of second and third quarter raw material will be very similar, the price increase is happening in this Q4 this year, this quarter.

Abhishek Datta: And that you will pass it on to the customers with a quarter lag?

Rajendra Gogri: Yes, somewhere we have monthly lag, somewhere we have a quarterly lag. So, that's how it equalizes.

Moderator: Thank you. The next question is from the line of Kamlesh Kotak from Asian Market Securities. Please go ahead.

Kamlesh Kotak: Just I wanted to understand the revenue breakup in terms of the domestic and export, you are saying that backward integration and import substitute also is an opportunity and exports also. So, two to three years down the line what will be the pie look like in terms of the domestic and exports, if you can help us understand, or the growth rate at which they both will be shaping up?

Rajendra Gogri: Actually we are currently at 60:40 level, so the similar level I think it will be local between 50 to 65, that range; and export 40 to 50, those ranges should happen. Export I don't think will cross 50.

Kamlesh Kotak: Okay. So, you see both of them are growing at a reasonable space, right?

Rajendra Gogri: yes.

Kamlesh Kotak: Okay. And secondly sir, within this Speciality Chemical, we are catering to multiple industries. So, any particular industry or the segments which you believe from next year's horizon will grow faster or which of them would have slightly moderate growth?

Rajendra Gogri: One is that engineering polymers or globally growing at 7%, 8%, that was pre-COVID, so two years we have knockout. But then I think it will go back to the same, because it is replacing metal in so many areas. And agrochemical growth is always going to be molecule specific, so we are in some of the innovator pipeline, somewhere which are on a growth phase, we will be participating in that supply chain for agrochemical. And adding to that, construction and all, whatever paints and all, and I think post-COVID because of the change in working style over I think going forward the construction could increase across the world, because people want bigger houses than what they used to have, so I think that should be an additional jump for construction related like paints and all.

Kamlesh Kotak: Okay. And sir, just wanted to have a flavour of this CAPEX which we are doing, any of that are already falling under the government's PLI scheme or how much investment of our is planned as of now which we have incurred, or we are going to incur will fall under the PLI scheme, anything which we have formed upon that side?

Rajendra Gogri: No, nothing is in PLI scheme, because PLI scheme has been announced so far for pharma and some very few specific pharma intermediates. So none of our products go into that specific molecule, but we make raw material which go into those intermediates and APIs. So our demand will increase but that will be a feeder to this PLI product.

Kamlesh Kotak: Okay. And then lastly, sir, in terms of the export, do you see any geography doing better or any pockets which have still not recovered fully, how the overall recovery on the export front is looking?

Rajendra Gogri: Generally the customer makes the end product and then they supply all over the world. So some time a product we export to Europe, it is not for European consumption. They make the product and then they sell it world over, we send to U.S. in the same way. So in that sense, there is no geographical impact.

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

Harsh Bhatia: Just two quick questions. Let's say the demerger goes ahead, and if I am not wrong, Speciality Chemical would still have some exposure to pharmaceuticals, right? And if yes, what would be the proportion of that exposure?

Rajendra Gogri: Yes, that we will have to calculate. But we make a very big pharma intermediate, PNCB, which is going in paracetamol. So in our chemical business, that is one of our big molecule which goes into pharmaceuticals. And then there are some other ones also. So we will have to calculate the number.

Harsh Bhatia: That's helpful. And just lastly on the dicamba site, have you started any negotiations or discussions for the intermediate that we already have in place? And how is the market looking, the international market such as China, Western Europe?

Rajendra Gogri: I think things will get clearer post this summer.

Harsh Bhatia: For the dicamba, sir?

Rajendra Gogri: Yes, dicamba, how does the growing happen in U.S. this year, that will give more clarity in second half of the calendar year, how the growth will happen. And some growth will happen in Brazil also in coming years. We expect the demand to grow from next year onwards.

Harsh Bhatia: And we will still be evaluating a forward integration aspect as well, along with other opportunities?

Rajendra Gogri: Yes.

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

Ankit Gor: Sir, just trying to understand in detail our ambition to reach 20%, 25% ROCE. In light of our existing business, if we break that up, Chemical gives us 17% ROCE, pharma gives us 22% ROCE. If we demerge pharma then obviously with existing business our blended ROCE is about 14% to 15%, and if we demerge pharma then our blended ROCE will further come down, probably. So in light of it, on top of it we are doing CAPEX of about Rs. 400 crore in Speciality Chemicals over next five years, how do you see ROCE pans out to reach to those 20%, 25% ex of pharma, we should be doing 30% plus EBITDA margin then only we can reach to about 20%, 25%. So what is your stance overall, if you can guide me please. Thank you.

Rajendra Gogri: Generally, what happens, when you are in a CAPEX mode, the ROCE takes time to catch up, one, because of the capital WIP and second is you are on a ramp up mode. When the thing gets matured, then you can see those kind of things on ROCE. So year-on-year, sometimes the numbers might be less, but then I think more and more capacity utilization happens the ROCE will go on improving.

Ankit Gor: This 25% target is in that case for which year?

Rajendra Gogri: That is a stretch target, typically it will be around 20%. But what we see that with more and more value-added products, typically you will get more ROCE basically in a commodity it will be more on 10%, 12%, and if you go on highly value added you may go towards 30%. So, as we have more and more advanced chemistry, we see that the ROCE on those will improve.

Ankit Gor: In that case it will take more than five years to reach 25% ROCE?

Chetan Gandhi: Yes, one more thing which I can add over here is that when you are looking at the actual current ROCE, I would request you to kind of do a calculation excluding the capital WIP. Because as you know, the projects which are underway will not contribute to the EBIT. That's how considering that as a part of capital employed for the calculation purposes, will always give some distorted view. So if you want to do a proper comparison, probably removing capital WIP would be a better way.

Ankit Gor: Chetan, it will not help much, but on other data points if we see, the gross block addition in last 5, 10 years was 19% CAGR and EBITDA CAGR was also 19%. In that case I am not comparing revenue because there is a pass-through element as well. So, gross block is 19%, EBITDA is also 18%, 19% CAGR 10 years. So, how do we see this changing in that case? Even if you have to take that number up, EBITDA CAGR now this time around should be 25%, 30% in between and gross block CAGR should be 15% in that case?

Rajendra Gogri: Going forward on our value-added products, this ROCE when we say 25%, some products we can have of 30% and some 20%. So, the incremental product as you go more and more towards value added, we see that ROCE will go on increasing, that is broad. Currently, if you net off this capital WIP, it will be 20% plus, I think. But going forward, with more value-added products it should go up.

Moderator: Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to the management for their 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 question 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. Thank you for joining us. And you may now disconnect your lines. Thank you.