AARTI INDUSTRIES LIMITED

Aarti Industries Limited

Q4 FY20 Earnings Conference Call Transcript

May 26, 2020

Moderator: Ladies and gentlemen, good day and welcome to the Aarti Industries Limited Q4 and FY20 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 an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Shiv Muttoo from CDR India. Thank you and over to you, sir.

Shiv Muttoo: Thank you, Janice. Good afternoon, everyone. Thank you for joining us on the Aarti Industries Q4 FY20 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 would like to wish you all to be in good health and to stay safe in the current situation of COVID-19. I trust that all of you would have received the Q4 and FY20 financial results presentation that has been uploaded on the stock exchange website and emailed to you earlier today.

The financial year ended 31st March 2020, saw the business impacts on various sectors, including global economy witnessed slow demand in some large verticals, especially in agro chemical and automotive industry, stark volatile in prices of key raw materials and currencies, and finally the worldwide spread of the COVID-19 pandemic. Despite such exceptional business conditions, we had a very satisfactory year with several positive achievements. We delivered revenues that were marginally lower by 2%, but EBITDA was higher by 1.2% and margin expanded by 60 basis points to 21.1%.

Profit after tax increased by 8.9% to Rs. 536 crore. I would like to highlight that the reported figure for the quarter FY19 are not comparable as they are inclusive of financials of the erstwhile Home and Personal Care segment of the Company, which was demerged into a separate entity upon approval of the Scheme of demerger as approved by NCLT in June 2019. During Q4 FY20, operations of the Company saw disruption of about 10 days towards the end of the quarter due to the precautionary lockdown imposed by the government. There were restrictions on manpower, logistics and movement of goods for local supplies and exports. This had a commensurate impact on the quarter's financial performance, which has impacted the top-line by about 9-10% and EBIT of about Rs. 27-30 crore, especially with respect to the Speciality Chemical segment. This also resulted in some additional buildup of inventory as on 31st March, 2020.

On account of the above reasons the consolidated revenue of the company for Q4 FY20 was Rs. 1,190 crore as against Rs. 1,279 crore for Q4 FY20. Likewise, the consolidated profit after tax for the quarter declined to Rs. 110 crore of Q4 FY20 as against the consolidated profit of Rs. 125 crore for Q4 FY19. In the Speciality Chemical business, the weak raw material prices that are contractually passed on to customers saw a revenue declined by about 3% for the year. Operating profit, which we believe is an important variable for evaluating our business was almost unchanged to Rs. 773 crore and EBIT margin expanded by 80 basis points to 21.1%. Underlying this was a visible shift in contribution from value added chemistry that increased from 70% of revenue to over 75% of revenue during the year.

Production of some products was also constrained to some extent during the fourth quarter due to some shortage in the supply of Nitric Acid. During the year, such shortages had an impact on production during Q2 and Q4. While we derive operating leverage from higher capacity utilization across key manufacturing locations, the commissioning of facilities for delivering on long-term supply contracts and start of activities at the fourth R&D center in Q4 resulted in higher expenses and impacted profitability towards the end of the year. The benefits of these capacities are long-term in nature will start to accrue progressively from FY21.

On the production front, the production for Nitro Chlorobenzene was about 14,700 metric tonnes for Q4 and 59,650 metric tonnes for FY20. While for the hydrogenated products we have achieved production of about 2,315 tonnes per month for Q4 FY20 and an annual production of 2,217 tonnes per month for FY20. The Nitro Toluene production for Q4 FY20 was 2,850 metric tonnes while the annual production was at 8,600 metric tonnes. It may be noted that production for NCB and NT during the year has been impacted due to the shortage of key raw material, Nitric Acid.

The Pharma business that is included in the category of essential goods has continued manufacturing operations throughout this period. Revenues increased by 4%, while margins expanded by 250 basis points. The successful completion of U.S. FDA Audits at our manufacturing facilities testifies to our higher standards of quality management, governance and compliance that we believe is a key differentiator for long-term success selling to regulated markets. Going forward, capacity expansions currently in pipeline will drive deeper penetration in some key therapies such as Antihypertensive, Cardiovascular, Oncology, Corticosteroids, etc. We also have a strong pipeline of approvals and visibility to maintain growth momentum.

Overall, I would like to share with all of you that in our assessment we have performed satisfactorily in a tough year. We have invested over Rs. 1,100 crore in various projects and have made progress in expanding our manufacturing base, diversified our product mix, continue to invest in R&D/product/process development and created a solid platform for ongoing business expansion. We would also like to share with you an update related to the impact of COVID-19 pandemic on the various aspects of the company's business activity.

Manufacturing Operations: Following the directives of the Central Government, the Company had faced logistics-related challenges for the movement of raw materials, finished goods, manpower, etc. As a result, the Chemical manufacturing facilities of the Company had initially gone into temporary shutdown on safe mode in a phased manner; while the Pharma business being included in essential goods, has continued manufacturing operations throughout this period. Subsequently, based on our wider product profile, that includes key ingredients to various Pharma/Agrochemical intermediates, which are included in essential goods, we applied and were granted permissions to operate our Chemical manufacturing facilities and to enable movement of critical workforce, materials, etc. After securing the supply chain, logistics and mandatory compliance requirement, we resumed operations at our manufacturing units in the first half of April. These units are currently operating at about 80% capacity utilization. While supply chain and labor availability challenges are being seen, the company is taking adequate efforts, including revision in rates, wherever applicable, to secure resources and mitigate the threat.

Corporate office: At present in line with the Government advisory, the company's Head Office located in Mumbai is temporary closed and work-from-home has been facilitated for the convenience and safety of all our employees. Adequate data security measures and additional protocols have been introduced to ensure the safeguard of all sensitive information.

Customer Demand, Movement of Materials: Over 60% of the Company's revenue comes from end use applications such as Agrochemicals, Pharma, Fertilizers and FMCG, which are vertical that have not seen any significant impact of the COVID-19 pandemic. Hence, the Company's business to that extent, remains largely protected from the currently significant changes in the operating environment. Globally, the discretionary portion of customer spending in sectors such as Automotive, Aviation, Real Estate, Textile, Electronics, etc., is expected to remain weaker over medium-term as compared to the past trajectory. In view of this, some of our products with end-use applications such as Polymers and Additives, Dyes, Pigments, etc., are witnessing demand contraction, which is difficult to assess accurately at this stage.

On the other hand, with rising global concerns, global supply chains are looking to hedge their risk and restructure their buying decisions to reduce reliance on supplies from China. This provides the opportunity for Indian manufacturers to expand their presence and market share in global market, which is an opportunity the Company continues to pursue aggressively. Given this changing dynamics, the Company is closely monitoring the situation and will take necessary steps to ensure optimum utilization of its units and also identify potential growth opportunities for long-term. In this respect, the Company's large number of long-term client engagements and the wide range of products with varied applications provide the flexibility to adequately align its production with ongoing shifts in global demand.

The Company shall be able to provide better guidance once we have more clarity on the matter. It may also be noted that Company expects the execution on its long-term contract to be on track and does not expect any significant impact from the COVID-19 pandemic to these contracts, production for which has been started recently. Further, the Company is facing certain challenges related to movement of materials at the port, especially at JNPT in Mumbai. The Company is monitoring the situation closely and taking adequate steps, including routing exports from other alternative ports in Gujarat to prioritize its shipments.

Project execution: On account of the lockdown announced by Central and State Governments and also due to restrictions in manpower movement, migration of labour and delayed delivery of equipment, work on the Company's expansion projects had been impacted at the start of the current financial year. The Company has prioritized certain activities to manage the timelines of critical projects. While, there may be some delay in the project works, the Company is closely monitoring situation and will take adequate steps to secure resources as may be required.

Financial position: The Company's financial and liquidity position remains strong, based on robust internal accruals and a well-capitalized balance sheet. The Company has continued to meet all its financial obligations on time. Increments for all eligible employees have already been announced and these are in process of being released at present. The Company has also extended support by providing additional monetary assistance and food rations to various temporary workers/laborers whose lives are affected due to the lockdown. In addition to existing resources at its disposal, the Company has secured additional credit lines to safeguard liquidity and meet all the obligations in the future.

Let me reassure you that the management continues to closely monitor all key developments across its various aspects of business and is taking adequate steps to address any impending issues. While we assess situation, we believe that we would have a flattish year in FY21, with a substantial impact coming in Q1 FY21 due to the lockdown and with recoupment of the same over subsequent quarters. From FY22 onwards, we expect to continue on to our long-term growth forecast of CAGR 15-20% bottom-line over a 3-4 year period.

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

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. We take the first question from the line of Surya Patra from PhillipCapital. Please go ahead.

Surya Patra: Sir, if you could clarify – having started the first/initial phase of the commercial supply deal related to Agro, has the fourth quarter factored in any meaningful revenue out of it? What would be the likelihood of progression in terms of scale-up, etc. for the first project? The second project is expected to be commissioned within six months' time, would that certainly happen starting second quarter?

Rajendra Gogri: Yes, in this Q4 we had desptached some material, however it would have very less as compared to the overall revenue of the company. So there is not much impact on the revenues.

Surya Patra: On the first supply deal – you said that in the fourth quarter, there were hardly any revenues. When could we see the benefits? What is the likelihood of progression to a meaningful level in FY21?

Rajendra Gogri: Yes, the benefit of this contract will start accruing progressively in FY21. On the second contract, the full-fledged commissioning will happen in the second half of FY21.

Surya Patra: Would the full supply contract see the exit rate to be – in terms of utilization, around 15% of the total anticipated revenue or would it be higher/lower than that?

Rajendra Gogri: Yes, there is proper structure in place (for the contract). Thus, that corresponding impact will been seen in the margins. It may not be totally/directly connected to the volumes.

Surya Patra: Would it mean that it is on a contracted basis where – the off-take is not proportionately higher but the revenue will be booked proportionately; since there would not be an increase in volume?

Rajendra Gogri: Yes, there may not be a direct linkage but there will still be some positive impact on profitability.

Surya Patra: On the COVID-19 impact for the quarter – obviously, it is well understood that there was a challenge related to logistics and it was just mentioned that currently, the Company is facing a challenge at JNPT. What would be the kind of revenue loss on the export and domestic front due to COVID-19 in the fourth quarter? Would you see a larger impact of that on the first quarter?

Rajendra Gogri: Yes, for Q4 there is an impact, on revenues, of ~Rs. 100 crore on Speciality Chemicals. For Q1 – in April, Speciality Chemicals operated at ~50% volume and in May it is ~80%; this is because some customer plants in Gujarat have not yet started including the end use sector ones. Hence, the first quarter will be definitely impacted because of the lockdown.

Surya Patra: Would it be better/weaker than the March quarter?

Rajendra Gogri: Yes, it will be weaker. In Q4, we lost 10% of the quarter, in Q1, it will be 15 days out of 90, which is more than 15%. Hence, the impact will be more.

Surya Patra: Was the revenue mix impacted to a certain extent – i.e., a likelihood of value added products which could not be manufactured because of the limitations? The value added products, for the full year, contributed to 75% of the revenues. Is it disproportionate to the quarter?

Rajendra Gogri: I don't have those numbers right now, but it will be of similar proportion. There would not be a big difference.

Surya Patra: The last question is on margins. There are various things that are going to happen/are happening currently, like – the product mix will change with the commissioning of the new project, there will be price corrections (in the final product) as the input prices are relatively lesser and the impact of COVID-19 would be visible throughout the first quarter with the likelihood of an impact from the global slowdown. Hence, considering all this, the earnings guidance for FY21 is of around 15-20%; could you elaborate on that? How do you see margin progression from the current levels as a whole?

Rajendra Gogri: No, I will clarify it as you have misunderstood. FY21 will be a flattish year and as of now, we are not able to give any clear guidance for the year. There will be further clarity after the first quarter and when there will be clarity on the global demand situation. Hence, now FY21 is expected to be flattish but in the subsequent years, it will grow. Considering FY20 as a base, we see 15-20% growth rate for three to four years. Albeit, FY21 is a bit of a black box and is flattish; it could be higher or a little lower, that is uncertain.

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

Arun Prasad: Could you throw some light on the NCB and Chlorination expansions? The demand side could still be a bit cloudy during FY21, but would the capacities be readied this year or would there be delays on the commissioning of these expansions?

Rajendra Gogri: Yes, the Chlorination expansion is expected to happen in Q1 FY21 or around July, Also, there is a project delay of one to two quarters because of the lockdown which will impact Nitro Chloro Benzene – the full-fledged expansion of which is expected by FY21 but may go on till middle FY22; albeit, the first phase will take place this year (FY21).

Arun Prasad: Is there any differentiated demand from the customers who used to get their supply from China? Has there been an increase in demand from them in terms of diversification of the procurement sources?

Rajendra Gogri: Yes, it is now a secular trend that people want to buy from India and require that the supply chain be independent of China. This is where companies like ours pitch in – on account of complete backward integration. Hence, we have the opportunity to create much higher-value-added products also. This trend should continue post recovery as well.

Arun Prasad: It was mentioned that COVID-19 had a negative impact on Q4 of about Rs. 100 crore. In the first two months, i.e., January and February, China closed much earlier than the rest of the world. There should have been some positive impact in the first few months because of that. Could you elaborate on that front?

Rajendra Gogri: That started happening after the middle of February/March; when the lockdown was imposed in India; without any substantial benefit out of it. The Chinese impact started around the Chinese New Year in February.

Arun Prasad: So, no impact?

Rajendra Gogri: No.

Moderator: Thank you. The next question is from the line of Sudarshan Padmanabhan from Sundaram Asset Management. Please go ahead.

S. Padmanabhan: Looking at the overall business – 60% is from the 'essential' products – Pharma, FMCG and Agri; the rest is 40%. With respect to the essentials, what is the demand outlook? What are these essential and non-essential parts and how do is the demand from the customers, primarily in the near-term and the longer-term?

Rajendra Gogri: Agro would be better this year, than the last year. In the last year, we had mentioned that – the Agro segment was impacted in FY20 because of the weather conditions in the U.S. Hence, FY21 should be a normal year for Agrochemicals. On the non-essentials – we have to see how things pan out, especially textiles – whether people are buying textiles; or even autos, etc. There is a view that there will be increased purchase of auto because people would want to drive themselves instead of taking an Ola/Uber. Things are not very clear. The auto demand may increase subsequently in second part of the year and maybe in the future. Aerospace would definitely be negatively impacted. In electronics, we would have to see. Overall, the global economy itself has slowed down – Europe is expected to be more than minus 5% and U.S. is also going to be in the negative territory. All those would impact discretionary spending. As time goes on and once things starts to open, we shall get more clarity. Like in Europe, they have already started resuming. That will then give an idea regarding purchase behaviors in next one/two months and further clarity on non-essential purchases.

S. Padmanabhan: On the non-essential products – what would be the chunkier part of the industry? Would it be auto or electronics? What would the components of the 35%/40% be?

Rajendra Gogri: One-fourth of it will be more of textiles; some may be from paints and houses, others petroleum additives. So, anything between 15-25% and spread over five to six sectors – textiles, construction, auto, aerospace, electronics, petroleum additives and rubber chemicals.

S. Padmanabhan: The second question is on the listing of Aarti Surfactants. Where are we at this point of time and when do we expect clarity on its listing?

Chetan Gandhi: We have been following up with the SEBI authorities. While there are no open pending matters to resolve from our end, we await SEBI's approval on this matter. We expect it to be resolved within the next 45 days or so. Our team follows-up with SEBI to see where and how it can be expedited.

S. Padmanabhan: Looking at the presentation – is says that supplies of nitric acid impacted the Company; assuming that it is because crude prices have declined that the Company holds high cost inventory. If you could provide clarity on – the availability of raw materials and product pricing, likely for better margins in Q1? Could you quantify the Company's hedging as there are MTM gains/losses every quarter; and how it is treated?

Rajendra Gogri: See, in general raw material price movement doesn't impact. The price of Benzene does cause impact, in the last quarter it was Rs. 51/kg. In April-May it crashed to Rs. 37/kg and then to around Rs. 20/kg.

S. Padmanabhan: Sir, I couldn't get the part of below the Rs. 20/kg.

Rajendra Gogri: Some products that have a quarterly lag will continue to benefit. Overall, some inventory loss will accrue in Q1 because of the sharp correction in Benzene.

S. Padmanabhan: On the question on hedging?

Rajendra Gogri: In our contract, it is the rupee portion for exports of one to three years, proportionally; in the first 12 months it could be higher, the next 12 months, a little lower and in the third year it would be further lower. This is a broad policy. In general, $50 million to $80 million is kept hedged for the following three years which have a corresponding impact on a quarter-to-quarter basis.

Moderator: Thank you. We take the next question from the line on Naushad Chaudhary from Systematix Shares. Please go ahead.

Naushad Chaudhary: On the volumes – if you could share the PDA and Nitrotoluene volumes as well.

Chetan Gandhi: The PDA volumes were roughly around 378 tonnes per month. Nitrotoluene volumes for the quarter were close to 2,850 tonnes for the quarter.

Naushad Chaudhary: Just to confirm – NCB was 14,700 and Hydrogenation was 2,315 per month?

Rajendra Gogri: Yes.

Naushad Chaudhary: Since 3-4 months, there have been raw material related challenges in Pharma. What is the current status and has it been resolved?

Rashesh Gogri: In Pharma – there were some supply related issues as some of the intermediates were coming from China. Post March, the China supplies were improved and we were able to receive regular shipments. We are maintaining higher inventory of all the critical intermediates that are needed for manufacturing APIs. The situation will get resolved in the coming quarter, as far as the intermediates are concerned.

Naushad Chaudhary: What would the guidance be on margins on Chemicals and Pharma?

Chetan Gandhi: It is very difficult to make a comment on the margin percentage because the percentage is linked with raw material prices which would be a bit softer this year; it could be volatile as we move ahead. On the Pharma side, we are targeting an overall increase in revenues and bottom-line by around 20-25%.

Moderator: Thank you. We take the next question from the line of Rohan Gupta from Edelweiss. Please go ahead.

Rohan Gupta: On CWIP – most of the projects are close to a 12-18 months' timeline/gestation period. We are close to Rs. 1,400 crore worth of CWIP as on FY20. Over the last two years i.e., FY19 and FY20 we spent close to Rs. 2,000 crore as cash flow, but the capitalization was hardly Rs. 400 crore during FY 20. Thus, in FY21 we are going to see huge capitalization of the CAPEX. Could you provide a number on the expected capitalization and the CAPEX in addition to the Rs. 1,400 crore CWIP in the current year?

Rajendra Gogri: The capitalization would be to the tune of around Rs. 1,400-1,500 crore or more. Some of the projects which we would start now may also get capitalized. Overall CAPEX that we are looking at is around Rs. 1,000-1,200 crore for this year.

Rohan Gupta: Despite the expectation of some spillovers/delays in NCB, CAPEX and the like; are we still expecting Rs. 1,000-1,200 crore in CAPEX? Could you provide guidance on the CAPEX and the related projects?

Rajendra Gogri: NCB was around Rs. 150 crore and that project will continue. The third contractual project (which we have signed), there, there is around Rs. 135 crore of that project. On the Chlorination project, part of that will be further spent on this in FY21.

Rohan Gupta: With the current weakness in overall demand, we expect delays in pickup from both of the new contracts. Also mentioned earlier was that the second contract will be carried forward to H2 and there will be a gradual pickup in the first contract which has already been commissioned. With large capitalization of almost Rs. 1,500 crore in this year, would there be a severe impact on interest and depreciation with a lower utilization? Thus, is the guidance given a flattish one and is it more at the bottom-line/ at the EBITDA level?

Rajendra Gogri: It is at the bottom-line level and is taking into account the higher depreciation.

Rohan Gupta: Thus, it is already factoring in higher interest and depreciation. At the EBITDA level we are expecting at least 10-15% growth, right?

Rajendra Gogri: Yes.

Moderator: Thank you. We take the next question from the line of Nav Bhardwaj from Anand Rathi. Please go ahead.

Nav Bhardwaj: Regarding an earlier notification, it was mentioned that – the Company would be entering into additional new lines of chemistry and products which would have multiple levels of synthesis. Could you throw some light on that? The notification was released on the 23rd of previous month.

Rajendra Gogri: We are starting a new R&D center in New Bombay where there will be an addition of newer chemistries like – photo chlorination and the like. This is currently under development and the construction is expected to start by the end of FY21 for the newer chemistries. That should mainly come in line in FY23, i.e., the newer chemistries and newer products.

Nav Bhardwaj: What kind of size would we expect these products to be in?

Rajendra Gogri: We would be expanding our chemistry range. On a long-term period, maybe Rs. Few thousand crores is the kind of volume can be generated from the newer chemistry and newer product lines.

Nav Bhardwaj: About the guidance that was given beyond 2021 – that 15-20% was CAGR over a span of two to three years?

Rajendra Gogri: Yes, it is three to four years to the base of FY20. FY20 will definitely be more than 15-20%. FY21, we do not know what the baseline/intermediate line that we will see in FY21.

Moderator: Thank you. We take the next question from the line of Atishray Malhan from Dron Capital. Please go ahead.

Atishray Malhan: You cited that – COVID-19 impacted EBIT by about Rs. 27-30 crore in Q4. The COVID-19 impact was only a week or so in this quarter and most countries had restrictive restrictions, during the end of March. Could you explain that please?

Rajendra Gogri: There was a 10% revenue impact that translates to around 17-18% on the EBITDA level as the salaries to laborers and the like were paid; and a lot of expenses to continue. The impact on EBITDA tends to be much more than the direct revenue loss. Revenue loss would be around 9-10% as some exports were stuck.

Atishray Malhan: You have indicated a flattish earnings growth for FY21. Considering a decline in earnings in Q1 FY21, do you expect Y-o-Y earning guidance to remain on account of better subsequent quarters?

Rajendra Gogri: Definitely Q1 was impacted Y-o-Y also, compared to Q1 FY20. Albeit, looking at the year as a whole, we would possibly get improved results.

Atishray Malhan: Could you give a quick update on the three long-term contracts – where they are at and if the production has started?

Rajendra Gogri: On the first two contracts, the initial start was in Q4 this year. Major volumes will start coming in/ getting ramped-up in FY21, in the first half, for the first contract. For the second contract, it will be in the second half of FY21. The third one, which was originally thought of for Q4 FY21 might get delayed to first half of FY22.

Moderator: Thank you. We take the next question from the line of Resham Jain from DSP Investment. Please go ahead.

Resham Jain: On the long-term contract with Rs. 400 crore of CAPEX. It was mentioned that it got commissioned in Q4; has the capitalization happened in Q4?

Rajendra Gogri: No. It was the first phase, so the capitalization is much lower.

Resham Jain: Some part of it has happened in Q4?

Rajendra Gogri: Yes, a very small part of it.

Resham Jain: Majority of the capitalization will happen in Q1, i.e., this quarter?

Rajendra Gogri: Yes, it will happen in first half of FY21.

Resham Jain: On the long-term contract – the original plan was of 40% margin on Rs. 400 crore of peak revenue expected in two to three years. However, what the Company is seeing is that – even though the revenue will not be much, perhaps because of absence of off-take from the Customer, would there be investment returns? How should one look at?

Rajendra Gogri: There is a structure in place – on account of lesser volume, a compensation would need to be paid.

Resham Jain: Would that be lower than the kind of margin you will earn?

Rajendra Gogri: Yes, it will be a little lower.

Resham Jain: On the balance sheet – there is an increase in non-current liabilities of Rs. 350 crore. What is that related to as there is a significant increase there?

Chetan Gandhi: That is related to the long-term advantage against the contracts. So, as of the 31st of March, 2020, there is roughly around $70 million, which is the advance collected from the Customers over the last two years or so, which was outstanding.

Resham Jain: Is this basically the advance received from the Customer against the project?

Chetan Gandhi: Yes, it is against the future supply and will be adjusted over the seven to eight year supply.

Resham Jain: Is this for the second contract?

Chetan Gandhi: The advance is for both – the first and the second contract.

Resham Jain: The whole amount of Rs. 350 crore, would it be related to that?

Chetan Gandhi: The entire amount of $70 million would be more than Rs. 500 crore. The larger chunk of this non-current liability would be related to that.

Resham Jain: On the CAPEX of around Rs. 1,000 crore this year – from the cash flow perspective, Rs. 1,000 crore is in addition to Rs. 1,400 crore of CWIP which is pending, is that right?

Chetan Gandhi: Yes.

Resham Jain: Would it be possible to give a breakup of the kind of capitalization that will happen out of the total sum because it is Rs. 2,400 crore of total capitalization over the next 18 months or so? When would the larger part of it get capitalized – i.e., Q2, Q3, Q4 or the next year?

Chetan Gandhi: We would have to work that out considering delays in a couple of projects.

Moderator: Thank you. The next question is from the line of Keshav Lahoti from Angel Broking. Please go ahead.

Keshav Lahoti: The second and fourth quarter of last year were impacted due to the shortage of Nitric Acid. How is the situation now and how will this year – FY21 pan out?

Chetan Gandhi: Earlier, they faced challenges related to the facility expansion which was coming up. We believe that this would be majorly resolved, according to our regular discussions with them. Keeping our fingers crossed, we do not expect any major challenges on the supply of Nitric acid. Will have to watch as to how things progress.

Rajendra Gogri: There is enough capacity, unless there is a breakdown in their plants or issues with raw materials. Otherwise, in India, we have enough capacity.

Keshav Lahoti: Is the Company now at 80% capacity? Would it be due to a shortage in demand or labor that we are not operating at full capacity?

Rashesh Gogri: Yes, there are issues related to demand and labor. Albeit, the labor related issues have been largely sorted out. There are some partial demand related issues in certain products.

Moderator: Thank you. We take the next question from the line of Rahul Jain from Lionrock Capital. Please go ahead.

Rahul Jain: The long-term secular trend of supply is shifting from China to India. Has there been an increase in the overall intensity/communication from your customers with respect to supply shifting away; giving you more orders/volume going forward. Has that changed dramatically? With respect to the profit growth guidance over the next three to four years – on the base of FY20, would the profit growth over the next four years from FY21 to FY24 be about 15-20%?

Chetan Gandhi: Yes, the understanding is right on that basis. Could you repeat the first question again?

Rashesh Gogri: We are getting inquiries and additional demand from China, from our global customers. That phenomenon has started since the last one year or so and is going to continue. Albeit, due to the current situation there is uncertainty everywhere so, in the last couple of months, these discussions have slowed down slightly We hope that they will resume going forward.

Rahul Jain: On the hedges – the hedging policy was started a year or two ago. Has the Company been consistently hedging more or is it that once the previous hedging program runs out, no further hedging would be done?

Chetan Gandhi: The Company has maintained a policy considering the overall business and long-term tenures. It is not only because of the long-term contracts of 10 years and 20 years but also because of various products wherein there could be contracts of three years or four years. Therefore, the delta part in the dollar-rupee component of those contracts needs to be protected and we took cognizance of that. Between $50-80 million is the hedge book that will be consistently maintained. We started with this almost two years ago.

Rahul Jain: It will be continued and is not a one-off program?

Chetan Gandhi: Yes.

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

Ranjit Cirumalla: On the project/contract front – the Company entered into this project/contract a couple of years ago when Crude was already at a different level than now. Would this change the dynamics of that project/contract? The guidance was for 40-45% EBITDA margin for sales of around Rs. 400 crore. Would there be any change with regards to these numbers?

Rajendra Gogri: No, the absolute number remains same. The percentage will increase and the raw material price will be slightly lower. Generally, Benzene is always a pass through model to Crude oil based products as our raw materials. Even if Benzene is Rs. 50/ Rs. 100 or Rs. 25, it does not affect the absolute EBITDA level but only as a percentage; if the Crude is lower the percentage margin goes up.

Ranjit Cirumalla: Would this be true for the other two projects as well?

Rajendra Gogri: Yes, one thing is very clear – for any long-term contracts the raw materials will always be passed through as, a risk with raw materials cannot be taken in any long-term contract. This will apply to yearly contracts as well, because Benzene's price could even double in the span of a year. Thus, the one year contracts will also have the raw material component in it.

Ranjit Cirumalla: Crude oil is different altogether. It could cover the fixed cost and the overhead cost. Beyond a point, could the pass through become difficult?

Rajendra Gogri: No, any contract which is one-year or longer, will always have a pass through component; be it Benzene, Crude oil or a corresponding raw material. Benzene will always get passed on. Only in quarterly contracts, which are many, it does not get passed through even if at a point Crude falls. For any of the one-year or longer duration contracts, the raw material component will always get passed through.

Ranjit Cirumalla: How have the PDA prices been since the Company has benefitted slightly in the past, some clarity on that would help?

Rajendra Gogri: We have to see once the market starts opening up. In India, the textile business and the like have still not reopened. Once, they do, then we will have an idea about the situation. A little bit of softening can be seen, but the entire clarity is expected in June – when the new price stabilizes.

Ranjit Cirumalla: On bookkeeping – what would be the inventory hit/loss in this particular quarter? Did the MTM or the FOREX impact only the fourth quarter?

Rajendra Gogri: The inventory loss is not much for this quarter.

Chetan Gandhi: We do not have any significant inventory impact in Q4, the impact is not there. The major impact of the Crude fall or the Benzene would come in Q1 FY21. With regards to FOREX – the impact is that the interest cost is up by around Rs. 7 crore. On the revenue, the interest cost is up by around Rs. 8 crore because of MTM on the ECBs. Overall, the revenue has an impact of around Rs. 7.5 crore, this is also provided by the way of a note to the account.

Rajendra Gogri: In the opening remarks, it was mentioned that there was an impact of Rs. 27-30 crore on the EBITDA. Was that due to COVID-19?

Chetan Gandhi: Yes.

Ranjit Cirumalla: Due to COVID-19, the utilization rate was lower, right?

Rajendra Gogri: Yes, that was a COVID-19 related number.

Moderator: Thank you. Next question is from the line of Abhijit Akella from IIFL. Please go ahead.

Abhijit Akella: On what you said earlier – for FY21, looking at the flattish bottom-line PAT number, what kind of contribution, from the new projects, are we building into this? Can we assume that it would be roughly half of the full year potential, from those projects?

Rajendra Gogri: Yes, a little more than that in the first year, for the first contract.

Abhijit Akella: Out of the Rs. 160 crore potential, a little more than Rs. 80 crore is what we can build in for this year?

Rajendra Gogri: Yes, it will be more than that.

Abhijit Akella: On the second one – would that also be similar?

Rajendra Gogri: No, the second one is to commission only in the second half and there will be a one quarter impact. It is more of a 25% thing.

Abhijit Akella: On the CAPEX plan – does the Rs. 1,000 crore figure include maintenance as well or they purely growth projects? If you could give provide a breakdown for this.

Rajendra Gogri: It includes maintenance CAPEX which will be typical of around depreciation numbers, may be about Rs. 250 crore.

Abhijit Akella: Among the others, you had mentioned a couple of contracts. On the Chlorination project, how much would we be incurring?

Rajendra Gogri: On Chlorination, we will be commissioning one plant in this year. Some more investment will be made on the Chlorination chain and that will be commissioned in FY22. There will be another couple of hundred crore projects in the Chlorinated product line.

Moderator: Thank you. The next question is from the line of Amar Mourya from AlfAccurate Advisors. Please go ahead.

Amar Mourya: Out of the Rs. 1,400 crore of CWIP, what would be the quantum of the second multi-year project?

Chetan Gandhi: The Second multi-year project is to have an outlay of roughly around Rs. 250-270 crore. Only a smaller part of that has started and the major chunk would be seen in FY21. Part of it would be there in CWIP and more spending will happen in the first half. No specific number on the Commissioning phase.

Amar Mourya: On the first contract - there will be a value in the CWIP, right? How much would it be and is it a substantial amount?

Rajendra Gogri: Yes and it will be a substantial amount.

Amar Mourya: Would it be around Rs. 300 crore plus?

Chetan Gandhi: Yes, it will be about Rs. 300 crore.

Amar Mourya: An approximate of Rs. 300 crore and about Rs. 250 crore for these, which is Rs. 550 crore out of the Rs. 1,400 crore for contracts one and two. Other than that how much would it be for the Nitro Chloro Benzene project?

Rajendra Gogri: Nitro Chloro Benzene is not significant. Our major Chlorination expansion is in Jhagadia.

Amar Mourya: How much would it be for the project in Jhagadia?

Rajendra Gogri: Roughly around Rs. 200 crore, for the Chlorination plant.

Amar Mourya: What would comprise of the remainder which is Rs. 700 crore?

Chetan Gandhi: There are a lot of projects that are taking place and we are also expanding capacities for both of the U.S. FDA approved plants of ours. There are various other projects which are going on and it will not be possible to quantify them at this time.

Amar Mourya: As indicated – in Pharma, the expectation is of around 25% growth on the revenue and the bottom-line front. Is that correct?

Rajendra Gogri: Yes, 20-25% top-line and EBITDA.

Amar Mourya: Is it largely due to on-going capacity expansion or on account of capacities expected this year? FY22 is to see further growth; but the 20-25% growth is for FY21?

Rajendra Gogri: FY21.

Amar Mourya: On volume growth – in Pharma, what would it be in FY21, on a full year basis?

Rashesh Gogri: Volume growth will be around 10-15%. There will largely be a product mix with a couple of products that are being launched for the U.S. market. Our partners have got approvals for those and these will start. Also, there are a couple of intermediate projects for the innovators that are going to get commercialized going forward. We will expect margins there.

Amar Mourya: Would there be an improvement in profitability on account of better pricing on these projects?

Rashesh Gogri: Yes.

Moderator: Thank you. Next question is from the line of Rohit Nagraj from Sunidhi Securities. Please go ahead.

Rohit Nagraj: On the first contract, where the plant was started in Q4 – is the per year, revenue potential Rs. 400 crore and Rs. 4,000 crore for the 10-year contract?

Chetan Gandhi: Yes.

Rohit Nagraj: We expect 50% utilization in first year, i.e., FY21, which would be around Rs. 200 crore and EBIDTA of 80 crs?

Chetan Gandhi: Mr. Gogri was referring to a query of the other analysts that in FY21 from the targeted EBIT of 40% EBITDA margin, Rs. 160 crore should have been generated at a peak level. So Mr. Gogri was saying that because of the kind of structure what we have in the contract, we should look at generating more, I guess, more than Rs. 80 crore, close to 60% or more than that much in terms of the first year in FY21. That is what we are seeing. So maybe the turnover would not be that much of 50%, but the numbers could be of that range.

Rohit Nagraj: In terms of debt – the long-term debt stands at around Rs. 600 crore, capitalization of over Rs. 1,400 crore with incremental CAPEX of Rs. 1,000 crore. What is the expected incremental debt in FY21?

Chetan Gandhi: The long-term debt is of Rs. 800 crore. The long-term debt repayments which fall in the 12-month period get counted as current liabilities. What has been noted is only the long-term/non-current part of the long-term debt. Thus, from Rs. 800 crore, Rs. 280 crore gets paid off this year. We would look at including – prepayment of NCD and cost optimization measures. Likely incremental gross debt would be between Rs. 700-800 crore, over the long-term to be raised in the current year.

Rohit Nagraj: In terms of other cost – the YoY number for other operating expenses has increased by 5-5.5%. Would there be further scope for optimization here? What would be the increase in other expenditure in terms of the fixed nature of those expenses in FY21?

Chetan Gandhi: There are a couple of additional sites which are coming on stream – the new R&D center came on-stream towards end of FY20, new project sites for the first and second contract will also begin full scale operations and the Chlorination unit is also moving into the commercial phase in Q1 FY21 or by July. Thus, there are these capacities which are going to come up and there will be an increase in costs on account of this.

Rajendra Gogri: That includes – asset management and administration costs which would have an impact there.

Rohit Nagraj: On the tax rate – what is the guidance for this year – FY21 and the next year – FY22?

Chetan Gandhi: It is likely to be a similar tax rate, i.e., between 20-21%.

Moderator: Thank you. We take the next question from the line Bhavesh Bajaj from Quantum Advisors. Please go ahead.

Bhavesh Bajaj: On the IT raid that was conducted on the manufacturing facilities and offices which was not associated with tax-related contingent liabilities – could you throw some light on why it was conducted and what the outcome was?

Chetan Gandhi: We believe that it was more of an investigative activity. We have not received a complete report on that as even the IT and others teams have been impacted because of the lockdown. We are awaiting their report. Even so, we do not see any significant impact on the Company's position.

Rajendra Gogri: They have not asked for anything. It is expected to go for further assessment. Albeit, we do not see any impact going forward.

Moderator: Thank you. Next question is from the line of Vishnu Kumar from Spark Capital. Please go ahead.

Vishnu Kumar: On production scheduling – what is the outlook/plan for the next quarter, especially during these uncertain times? What would be the lead time before which the customer's orders come through and manufacturing can commence?

Rajendra Gogri: On production scheduling – the Company has many export orders and they have visibility of 2-3 months. For the domestic orders as well, for most customers, there is a 2-3 month visibility, as according to their demand.

Vishnu Kumar: Considering a supposed run rate of 80%, would there be visibility that the products will get pushed out in the next quarter or so? Would it be that we are stocking up as we anticipate demand in the second or third quarter so that we can start supplying?

Rajendra Gogri: No, we can only stock-up for certain products as our volumes are very large and for certain products we cannot stock up at all. It depends from product to product. We do not stock up certain products where a long-term impact is expected. Currently there is a sharp reduction in some of the consumption in India, which has been around for more than 2-2.5 months. Due to this, suddenly, almost 20% of the demand for certain products is lost. Once they resume, it should be a bit more normal.

Vishnu Kumar: On the long-term contracts – would the customers be likely to reschedule the delivery supply chain by perhaps 2-3 quarters? Would the committed orders for FY20 be taken or would some of them be pushed into FY21?

Rajendra Gogri: No, we will get whatever is as per the contract.

Vishnu Kumar: Agro, Pharma and others have an end market of ~25-30% in each bucket. Earlier, on non-essential products, you mentioned that – Agro is doing okay and Pharma is seeing some growth. On these consumer products that the Company supplies to – if for instance, an Auto player, as you said where you will see a flat growth, would it be that the growth in Agro and Pharma will compensate for the other segment's decline; or is there a possibility of a top-line decline if the demand does not shape up?

Rajendra Gogri: Yes, you have said it correctly. We will have some growth in these sectors – Agro and Pharma and some decline in the others sectors. Currently, it is flattish and it can go a bit up/down, depending on the current situation. Obviously, Agro and Pharma volumes are increasing and are expected to increase this year. For Auto and Textiles, the volumes are expected to be down.

Vishnu Kumar: So both of these would compensate for each other and there will still be some growth in the top-line?

Rajendra Gogri: Yes. That is why it will be flattish; in the sense that – what exactly will pan out on the discretionary side and how people go out to buy Textiles now. People are spending less on entertainment, traveling and food after this pandemic, hence this expense is reducing but incomes are reducing as well. Thus, it depends on the spending behavior of people all over the world. It is a very complex scenario and is quite different than the recession in 2008, where this kind of an impact on the service sector was not there. Currently, the service sector is extremely impacted.

Vishnu Kumar: On your long-term contracts – does the currency depreciation benefit the Company?

Rajendra Gogri: Partially it gets passedon, partially we have to hedge.

Vishnu Kumar: I did not understand – is it that the benefit is partial or it is hedged?

Rajendra Gogri: No. For a certain portion, there is a structure in place; for the rest, we take a call on it.

Vishnu Kumar: Is it favorable to the Company, even if by a small margin?

Rajendra Gogri: Yes, since the Rupee is going down. Thus, for the portion that is to be hedged, either we would hedge that and get a 4% benefit of forward premium or keep it open. Although, the other portion is always there. In most of the contracts, we always have an inflation and FOREX matching effect.

Moderator: Thank you. We take the next question from the line of the Dipesh Mehta from SBICAP Securities. Please go ahead.

Dipesh Mehta: On the CAPEX plan and continuity – considering the weakness in the end-user industry and related flattish outlook, at least for the near-term, do we expect some slowdown? Looking at the Company's debt-to-EBITDA – EBITDA is likely to be more or less flattish or with a probability of marginal growth, next year. The Company's looking at a higher debt of ~Rs. 500 crore from the net debt perspective. What is the Company's overall philosophy about debt – how is it to manage Debt-to-Equity and Debt-to-EBITDA? What would be the comfort trend?

Rajendra Gogri: On account of COVID-19, a lot of projects have been pushed out by 1 or 2 quarters. Some of the construction has not started – it was supposed to start in April-May and will now get pushed to October-November. Thus, there is an impact far as the timing of the project is concerned. As mentioned earlier, the target debt will be in the range of 0.7-1 which was previously 0.8-1.2. Internally, we have revised the Debt-to-Equity target to be between the 0.7-1.

Dipesh Mehta: Would the Company not breach this given – the weakness now, the likely continuity of the situation for some time and maintaining of CAPEX?

Chetan Gandhi: No, we will not breach.

Rajendra Gogri: I do not think that we will be breaching that.

Dipesh Mehta: On Pharma – looking at the 20-25% of expected growth this year, the Chemical business seems to have more weakness despite expecting contributions from one of the long-term contracts. What would be the area of weakness – because if we were to do reverse working, despite Agro and Pharma, Chemicals seems to be doing reasonably well. The weakness seems to be more pronounced.

Rajendra Gogri: Yes, because 50% of the revenue for Chemicals is from discretionary spending i.e., all of the 5 sectors – Textiles, Auto, Aerospace and Construction and some Oil additives. Even fuel additives also will be lower as lesser people are driving. So, all those sectors are definitely globally impacted. Our idea will be continuously either take more market or reshuffle the product mix. Although, definitely so, there would be volumes on those sites for this year.

Dipesh Mehta: Any geographical difference – U.S. vs. Europe or another market?

Rajendra Gogri: Looking at the economic indicators, the contraction in Europe will be more than that in the U.S. The question that arises is – how would the spending habits of people change post the COVID-19 situation because the Service sector i.e., entertainment, restaurants and travel is going to be impacted. If that would be compensated for by changes in buying goods, then the impact on goods will be less. Thus, it is a totally new ballgame which has taken place. The clarity on the psychology and demand patterns, post June and July, i.e., when things get stabilized in West, may come about only in H2 FY21 i.e., from July to December.

Dipesh Mehta: Why I asked is because – looking at FY20, North America was flattish vs. Europe which was doing well for the Company. Is it expected to work the other way round in FY21?

Rajendra Gogri: Yes.

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

Harsh Bhatia: On Aniline – it makes up ~10-15% of the raw material. Is it 100% domestically sourced or is some part of it imported? This is in line with the antidumping duty that was filed in January against China. Thus, if the Company is imports from China, how would that be impacted and how is the management looking at it?

Rashesh Gogri: Yes. The Company imports close to 70-80% of the total requirement of Aniline. There are several sources – Chinese as well as European. We import from those against which we have export orders; thereby getting an exemption on paying duty. For our local requirement, it is procured from the domestic sources. Our total requirement is quite large and the domestic source cannot fulfill the entire requirement.

Harsh Bhatia: For *GNFC* and the other domestic players it accounts for almost 50,000 tonnes. In the next 1-2 years, perhaps the demand for Aarti Industries will cross that. The next question is on Pharma – when is the benefit to accrue on the API. *Gilead Sciences* has signed contracts with *Cipla* and *Jubilant Life Sciences*. How is the Company moving into the Remdesivir and Hydroxychloroquine API benefit that will come in? Where are we in the Pharma value chain – are we one step before the API or would we be producing the same API and supplying it to them?

Rashesh Gogri: Yes. As far as the overall API is concerned, our volumes of highly profitable products are going up, with increased approvals and newer customers onboarding us for their requirements. This will lead to a higher top-line growth as well as the bottom-line growth. On the COVID-19 based treatment related APIs – the Company is not present in Remdesivir value chain. We manufacture MNCB which is an important key intermediate for manufacturing Hydroxychloroquine; but that is at an intermediate level. So, we are not at a value-added higher or N-1 product.

Moderator: Thank you. We take the next question from the line of Avishek Datta from Prabhudas Lilladher. Please go ahead.

Avishek Datta: On the segments mentioned – like Textile, Auto and the like, what is the cumulative percentage that they account for?

Rajendra Gogri: It is of around 40% in Textile, Auto, Construction, Aerospace, Chemicals and Petroleum additives. Generally, we consider more of the discretionary.

Chetan Gandhi: Yes, these would be accounting for around 40%. We have largely considered it more from a discretionary spend perspective i.e., from the consumer spending behavior.

Avishek Datta: In the earlier presentation, Pharma and Agro typically account for around 35-40%, respectively.

Chetan Gandhi: Yes. You are looking at it from the perspective of as part of Specialty Chemicals. The Pharma segment itself is a separate 15%. FMCG is another 5-7%. All of that put together makes the revenue split for the Company, as a whole, of around 60% towards Pharma, Agro, FMCG and Fertilizer. The Pharma vertical is 40%.

Avishek Datta: There are reports of incentives being given by China i.e., ~13% of export benefits. Have you seen any increased competition from China because of that?

Rashesh Gogri: Not much, it is hardly ~2-3% in pricing because there is lot of volatility in pricing anyway on account of the crude oil price going up and down. So, perhaps those savings have been marked somehow. We do not see any major impact as such.

Moderator: Thank you. We take the next question from the line of Kishan Gupta from CD Equisearch. Please go ahead.

Kishan Gupta: The Company is looking at Rs. 1,000-1,200 crore of CAPEX. How much was the planned CAPEX before COVID-19?

Rashesh Gogri: Yes. It was about similar.

Moderator: As there is no response from the current participant, we move on to the next question from the line of Aditya Mongia from Kotak Securities. Please go ahead.

Aditya Mongia: On India substituting for China, in terms of Specialty Chemicals – what is the biggest bottleneck in accelerating this trend? What are the obstacles to the supply chain in the acceleration of substituting China?

Rajendra Gogri: That will be mainly for research and development. People have to develop the technology in Speciality Chemical and also set up the plant. The Government has to be more flexible on the product mix in terms of the environment in order to react faster if the product is developed. Thus, one will be – the development of product and second that – if you are given some flexibility in the product mix then that can expedite the idea. This is a very secular trend and will happen slowly. This is going to happen, as more and more products are developed and some of the products' growth/market share will increase from here. If there is a global growth, India will have more share of the products are already held.

Aditya Mongia: Then this is not as much of increased costing of Chinese products but a focus on R&D from the Indian plants that will lead this from here on?

Rajendra Gogri: Yes. Competitiveness in general has increased and because of that, a lot of products which were not competitive in India and might have technology, with those, we can enter the market faster. That is what we have seen for some of the products that were not made in India earlier and the imports of which were stopped, they started coming back. Thus, we will have to develop the product and put in the market. In the Chemical industry off-the-shelf technology for Speciality Chemicals is not available. On bulk Chemicals it is possible to get the technology; the technology of Silicon Hydride or Phenol and the like is available. For this, investments in R&D would be required.

Aditya Mongia: You most likely mentioned this in the light of the Company developing more products. Although, for the existing products, is there a thought process being shared by customers where they would want to ship right away i.e., from China to India and wherein both Chinese and Indian companies are competing?

Rajendra Gogri: Yes, absolutely. That trend is also prevalent – increasing the sourcing as a percentage from India. The benefit also definitely accrues from the existing products. For the newer opportunity, you have to invest money. For the existing products also, the volume growth will happen.

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

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

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