

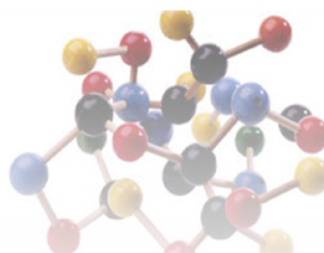
# Q1 FY17 Earnings Conference Call Transcript

3.00 PM IST  
August 11, 2016



**Aarti Industries Ltd**

RIGHT CHEMISTRY FOR BRIGHTER TOMMOROW





**Moderator**

Ladies and gentlemen, good day and welcome to the Aarti Industries Q1 FY17 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 telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Vikram Rajput of CDR India, thank you and over to you.

**Vikram Rajput**

Thank you. Good afternoon everyone and thank you for joining us on Aarti Industries Q1 FY17 earnings conference call. We have with us Mr. Rajendra Gogri – Chairman and Managing Director, Mr. Rashesh Gogri – Vice Chairman and Managing Director and Mr. Chetan Gandhi – CFO of the company.

We will begin this call with opening remarks from the management following which we will have the forum open for a Q&A session.

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

**Rajendra Gogri**

Good afternoon and a very warm welcome to all of you. Aarti Industries is poised very favorably in the speciality chemicals industry and is partaking in an exciting growth opportunity in sector. Last few years period was an extraordinary time for our company, one that we can look back on with pride. We have continued to deliver strong growth across every operational and financial parameter by achieving higher volumes, margins and profit. We have successfully engaged with our global clients who consider Aarti Industries their 'Global Partner of Choice'. All the while, we have been successfully executing our profitable growth agenda, executing expansion plans while progressively driving higher returns and creating value for our shareholders.

Coming to the Q1FY17 performance, we are off to a steady start in FY17 and are well positioned to deliver on our financial and operational targets. While revenue was almost flat at Rs. 683 crore our gross profit expanded meaningfully. As many of you are aware, our realizations are linked to global crude oil prices, so the key parameter to track is gross profit, which expanded 15% YoY to Rs. 321 crore from Rs. 279 crore. Of the total revenue for the quarter, Exports amounted to Rs. 341 crore, almost 50% of the total revenue. EBITDA improved 17% YoY to Rs. 155 crore from Rs. 132 crore, translating to an EBITDA margin of 22.6%. PAT grew significantly to Rs. 83 crore from Rs. 61 crore, marking a 36% YoY growth. Profitability performance was supported by approximately 11% YoY decrease in finance costs which benefited from lower interest rates.

In Q1FY17, speciality chemical revenue was flat at Rs. 551 crore. Revenue is linked to pass through of benzene prices that were lower by 17% YoY. EBIT expanded by 12% YoY to Rs. 133 crore from Rs. 118 crore, as value addition component of revenues continues to increase by leveraging our wide range of products. As you are aware, our business is largely operated on formula based model based on variation in raw material prices plus margins, wherein the delta is fixed in absolute basis and per kg margins remain stable. Hence, the raw material price fluctuations are passed on to the customers and the absolute EBITDA is based on volumes and product mix and not the price fluctuation. During the quarter, volume expansion was about 8% YoY.





Nitric acid supply constraints, which continued till early June impacting revenues in the NCB value chain, have since been normalized. We clocked production of about 13,900 MT of NCB during Q1FY17 as against the production of about 15,300 MT for Q1FY16. The company optimized on the available quantities of Nitric Acid and realigned its diversified product mix to reduce any impact.

The expansion blueprint is being executed as per plan. During the quarter, we commercialized calcium chloride facility at Jhagadia, Gujarat. We are expecting to commercialize ethylation unit at Dahej SEZ, Gujarat and PDA 2nd Phase at Jhagadia in Q2FY17.

Moving on to the Pharmaceuticals segment, Q1FY17 revenue increased by over 4% to Rs. 95 crore from Rs. 91 crore in Q1FY16. Debottlenecking and expansion activities have facilitated growth in pharma volumes. EBIT increased to Rs. 12 crore from Rs. 6 crore, marking 100% growth. Since major fixed costs are already built-in, incremental volumes result in significant increase in segmental profits. We expect to progressively improve performance in the pharma business to deliver profitable growth in this business.

In Home and Personal Care, revenue for Q1FY17 stood at Rs. 37 crore as against Rs. 34 crore. This business has only about 3.5% of the overall capital employed in it. We are making concerted efforts to gain larger scale and drive sustained improvement in this business.

To conclude, our belief around the transformation of AIL is strong. We have created a world-class speciality chemicals organization that is poised for substantial gains from scale and operating leverage. We believe we have the levers in place to consolidate our position meaningfully. Our strong leadership, global-scale operations, de-risked & leading product portfolio, co-product balancing, pioneering technologies, brand salience and strong financial position have placed us on a firm footing to capture emerging sector prospects and drive sustainable long-term value. Even in the case of Pharma segment, we have been consistently increasing our share of operations and engagement with various customers in regulated market space. The above along with successful closure of USFDA Inspection, has resulted into consistent growth in topline, increase in exports in regulated markets and corresponding EBIT over past few years and expect to continue on the growth momentum.

Our eyes are set on driving profitable growth, higher free cash flow generation and increasing return ratios, which tie up to build superior value for our shareholders.

On that note I conclude my opening remarks. We would be happy to give you our perspective on any questions that you may have. I would request the operator on this call to open question and answer session. Thank you.

**Moderator**

Thank you very much sir. Ladies and gentlemen we will now begin the question and answer session. We have the first question from the line of Abdul Puranwala from Centrum Broking. Please go ahead.

**Abdul Puranwala**

On the full year basis that is in FY16 there seems to be a revenue dip of around 10% which might be due to the IndAS classification. Can you give us some flavor on that?





- Chetan Gandhi** It won't be a dip of 10% it would be a dip of about Rs. 10 crore. It should be because of the IndAS conversion. It is largely related to the fair valuation of investments and regrouping of certain P&L items.
- Abdul Puranwala** In the current quarter we saw that the pharma just grew by 4%, may I know what was the reason for this slowdown in growth? Is it that the high base.....
- Rashesh Gogri** Last quarter where we had good growth and this was a quarter where we had little bit of slowdown in growth, We expect again current running quarter to be better.
- Abdul Puranwala** We do maintain the guidance of around 20-25% growth?
- Rashesh Gogri** Yes, we do.
- Abdul Puranwala** May I also know the PDA volumes for the current quarter?
- Rajendra Gogri** Current quarter PDA volume was partially affected because of the Nitric Acid shortage. The volume was about 600 tonnes in the current quarter.
- Moderator** We take the next question from the line of Saravanan Viswanathan from Unifi Capital. Please go ahead.
- Saravanan V** What were the Benzene prices ranging in Q1?
- Rajendra Gogri** The Q1 pricing was Rs. 44 and Y-o-Y it was Rs. 53 in the previous year.
- Saravanan V** How is it in the current quarter?
- Rajendra Gogri** Its going a little bit up but this is now more flattish.
- Saravanan V** This Nitro Chloro Benzene, I missed to note down the production numbers, how much was processed in Q1?
- Chetan Gandhi** It was 13,900 tonnes for this year and for Q1 FY16 it was 15,300.
- Saravanan V** In Q4 you had done approx. 12300. So for Q4 there has been some improvement?
- Chetan Gandhi** Yes.
- Saravanan V** Now you also mentioned that by end of Q1 itself some resolution had taken place so next three quarters what kind of capacity we can see?
- Rajendra Gogri** Now the Nitric Acid issue is more or less resolved, so in the rest of the nine months we expect to produce around 50,000 tonnes.
- Saravanan V** Tax rate what would be the guidance because for Q1 the effective tax rate seems very low, what's the guidance for the year?
- Chetan Gandhi** That more or less should be around 20-22 or marginally below 20%.
- Saravanan V** Any specific reason for this lower tax rate?
- Chetan Gandhi** Lots of expansion projects are getting commercialized this year, so there will be the incremental tax incentive which will be available, the one time incentive on the tax





	by way of additional depreciation which the government had announced is expiring in this financial year.
<b>Saravarnan V</b>	In the last call you had mentioned that toluene and ethylene based value chain projects will start in Q1. Have they started?
<b>Rajendra Gogri</b>	This is under commissioning and commercial production should start in this quarter, i.e. Q2.
<b>Moderator</b>	Next question is from the line of Mehul Seth from PhillipCapital. Please go ahead.
<b>Mehul Seth</b>	First question related to your toluene production plant. Which customers are you targeting initially? Is it same as your NCB customers?
<b>Rajendra Gogri</b>	Basically the toluene chain also has the same end use areas which is in agrochemical and pigment, printing ink and pharma, so customer base is very similar.
<b>Mehul Seth</b>	If you are talking about agrochemical then initially you will be looking for domestic agro players only, right?
<b>Rajendra Gogri</b>	This plant what we are starting in Dahej of ethylation is an SEZ so the product coming out of that plant is mainly for the export purpose.
<b>Mehul Seth</b>	One more question related to your speciality chemical business. Can you provide the mix between your NCB based, hydrogenation base and other process base volumes and performance?
<b>Rajendra Gogri</b>	Actually Nitro Chloro Benzene chain also has some hydrogenation product coming into that so it is difficult to differentiate between these various processes.
<b>Mehul Seth</b>	This expansion in margin you initially indicated because of higher contributions from your value added products, so can you throw some light on that part?
<b>Rajendra Gogri</b>	The topline was same but overall there was a volume increase of about 8%, so based on that we had about EBIT increase around 13%. So mainly on a higher volume and optimized product mix, we could get some extra operating profits which resulted into margin expansion.
<b>Mehul Seth</b>	Your CAPEX guidance remains intact like Rs. 4.4 billion that you have guided?
<b>Rajendra Gogri</b>	Yes, CAPEX of that order.
<b>Mehul Seth</b>	How much you have done till Q1?
<b>Rajendra Gogri</b>	Q1 we had done about Rs. 100 crore.
<b>Mehul Seth</b>	Remaining will be over this FY17?
<b>Rajendra Gogri</b>	Yes.
<b>Moderator</b>	Next question is from the line of Nihal Jham from Edelweiss. Please go ahead.





**Nihal Jham** My question relates to what is the volume growth expectation for the current year, is it still around 15% that we had mentioned last time around?

**Rajendra Gogri** The first quarter was already impacted so it was around 8%, so overall it should be between 10-15% on an annualized basis.

**Moderator** Next question is from the line of Vipul Shah from Monarch Network Capital. Please go ahead.

**Vipul Shah** The Toluene and downstream product plant we are putting at Jhagadia, is it a prerequisite for our ethylene plant in SEZ?

**Rajendra Gogri** Yes. That is going to be the feeder for ethylation plant at Dahej.

**Vipul Shah** So both plant you need to start together?

**Rajendra Gogri** No ethylation we are commissioning right now but the Nitro Toluene plant will be commissioned in the second-half of the year.

**Vipul Shah** What is the capacity of both the plants, if you can give me the number?

**Rajendra Gogri** The Nitro Toluene our capacity is 30,000 ton per year and ethylation plant again it's a multi-purpose plant so you can say between 8,000 to 10,000 tonnes per annum.

**Vipul Shah** So once you commission this ethylation plant without toluene, so you will be buying raw material from outside for initial period?

**Rajendra Gogri** Yes.

**Vipul Shah** Ethylation plant I think for couple of products you will be the first in Asia to manufacture?

**Rajendra Gogri** First one in India because it is already being manufactured in China. So in India we will be the first one to use ethylene by pipeline and make chemicals for agro and other markets.

**Vipul Shah** For any other product do you have any offtake agreement with the global MNC for this value chain?

**Rajendra Gogri** Yes.

**Vipul Shah** Can you throw some more light on that?

**Rajendra Gogri** That specific details we cannot share.

**Moderator** We have the next question from the line of Manish Jain from SageOne Investment Advisors. Please go ahead.

**Manish Jain** Chetan, just wanted to know in terms of the current debt both long term and working capital as on June. CAPEX I missed, Rs. 100 crore we have already in June quarter and how much are we planning and the balance nine months?

**Chetan Gandhi** The current annual estimated CAPEX plan on the plant and machinery was around Rs. 450 crore, so against that rs. 100 crore was spent in June quarter so balance





will be spent over the balance three quarters. And on the debt, the gross debt is roughly around Rs. 1,300 crore of which the long term debt should be around Rs. 540-550 crore, and the balance is short-term.

- Manish Jain** Next question I had on the significant change in profitability for the pharma side given that Rashesh just mentioned that we will be growing by 20% for the year, can we take the first quarter base as the base for profitability going ahead?
- Rashesh Gogri** Yes we can take that.
- Rajendra Gogri** Overall it should be more than four times what we have. Compared to the first quarter the next three quarters should be still on the higher side than that.
- Moderator** Next question is from the line of Dhiraj Dave from Samba Financial. Please go ahead.
- Dhiraj Dave** Just wanted to understand basically we are also looking at US FDA approval in Aarti Industries in pharmaceuticals and similarly we already have a group company Aarti Drugs, so how exactly the product, etc., gets distributed between these two businesses, what you decide exactly goes in Aarti Drug and what comes in Aarti Industries? Can you throw some light exactly how the business are segmented between these two companies?
- Rashesh Gogri** In Aarti Industries we have anti-cancer steroidal manufacturing facility as well as we focus on anti-hypertensives and CNS products. Whereas Aarti Drugs there we have more large volume products.
- Moderator** Next question is from the line of Mehul Seth from PhillipCapital. Please go ahead.
- Mehul Seth** Out of this Rs.100 crore CAPEX can you give a break up like how much is in speciality pharma?
- Rajendra Gogri** More than 85% is in speciality chemicals.
- Mehul Seth** One question related to your Toluene based end users. Is there any over lapping between your current customer using NCB based product and now you are going with the Toluene based products so is there any over lapping or anything like that?
- Rajendra Gogri** Generally in all these chemical industries chemicals are very specific. If somebody is using a NCB based product then they have to continue to use that to make the finished product. But the customer base is similar, the customer to whom we are supplying our Nitro Chloro Benzene based products they are also going to be our customer for Nitro Toluene also because the customer who are making a pigment or printing ink they make across the line lot of products which consume both Nitro Chloro Benzene as well as Nitro Toluene chain.
- Mehul Seth** How much utilization level you are expecting for this Toluene facility in FY17?
- Rajendra Gogri** This will be the first or the startup year so we don't expect the utilization to jump significantly. Since its expected to commercialise in the second half, the utilization may be around 25-30% but in 2-3 years it would ramp up and we should be reaching to more than 80%.
- Mehul Seth** How the realization in this Toluene based product like it is higher than your existing product or it is at what?







**Rajendra Gogri** It will be on a similar level because Benzene, Toluene prices are also more or less on similar level, both are crude oil based.

**Moderator** Next question is from the line of Chirag Dagli from HDFC Mutual Fund. Please go ahead.

**Chirag Dagli** What would be our pharma gross margin?

**Rajendra Gogri** This time it was more than 12% as EBIT margin.

**Chirag Dagli** Gross margins would be higher than business average?

**Rajendra Gogri** No.

**Chirag Dagli** When was the FDA inspection done?

**Chetan Gandhi** March 2015.

**Chirag Dagli** Was this triggered by our products or was this a general CGMP inspection?

**Rashesh gogri** All the inspections are triggered by the products only otherwise but this was a kind of third inspection for the same plant, so every 2-3 years based on the product FDA wants to come in and check.

**Chirag Dagli** So this was not a product specific but CGMP?

**Rashesh Gogri** It was product specific as well as even the last inspection prior to this we had surpassed three years so it was both basically.

**Moderator** Next question is from the line of Archit Joshi from B&K Securities. Please go ahead.

**Arhit Joshi** Could you provide us the volumes for hydrogenation for the two quarters, that is Q1 2017 and Q1 2016?

**Rajendra Gogri** For Q1FY17 it was about 5,100 tonnes. I don't have any ready number right now for the previous year.

**Arhit Joshi** For PDA it would be, in the last quarter, Q1 2017?

**Rajendra Gogri** It was 600 tonnes.

**Moderator** Next question is from the line of Kishan Gupta from CD Equisearch. Please go ahead.

**Kishan Gupta** How do you plan to fund the CAPEX, the Rs. 4.4 billion?

**Chetan Gandhi** We expect our cash accruals for the year to be pretty much strong considering the profitability and the depreciation and we have got a debt equity of 1.15. I believe the overall gearing would improve but there will also be a small component of debt which will come in, so it will be a combination of debt and internal accruals with an improvement in the gearing.

**Kishan Gupta** At what rate you have borrowed these NCDs?







**Chetan Gandhi** We have not taken anything so far.

**Kishan Gupta** You mentioned Rs. 200 crore?

**Chetan Gandhi** Rs. 200 crore NCD has been there since 2014.

**Kishan Gupta** When is it due for redemption?

**Chetan Gandhi** It was a 7-year thing so it will be there till 2021.

**Kishan Gupta** How much interest has capitalized last quarter?

**Chetan Gandhi** It would be roughly around rs. 6 crore.

**Kishan Gupta** And in the same period last year?

**Chetan Gandhi** It should be around Rs. 5 crore.

**Moderator** Next question is from the line of Saravarnan Vishwanathan from Unifi Capital. Please go ahead.

**Saravarnan V** Pharma can you give us the latest DMF count? How much has been filed, how much has been commercialized in regulated markets?

**Rashesh Gogri** We have total 26 US DMFs and we have 15 COSs.

**Saravarnan V** How much has been commercialized?

**Rashesh Gogri** Close to half of them have been commercialized?

**Saravarnan V** DMFs?

**Rashesh Gogri** Yes DMFs.

**Saravarnan V** Pharma, despite the slow growth seen in first quarter you are hoping that it will be 25% growth for the full year?

**Rashesh Gogri** Yes because we have some CAPEX going on stream, some plants coming on stream, so we will have expanded capacity and we see good market for these products.

**Saravarnan V** This is for regulated markets or other.....?

**Rashesh Gogri** Particularly caffeine.

**Moderator** That was the last question. I would now like to hand over the floor to the management for their closing comments, over to you sir.

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





**Moderator**

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

- ENDS -

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