AARTI INDUSTRIES LIMITED

"Aarti Industries Q4 FY 13 Results Conference Call"

May 17, 2013

AARTI INDUSTRIES LIMITED

MANAGEMENT: **MR. RAJENDRA GOGRI – CHAIRMAN & MANAGING DIRECTOR**
MR. RASHESH GOGRI – VICE CHAIRMAN & MANAGING DIRECTOR
MR. CHETAN GANDHI – FINANCE HEAD

Moderator: Ladies and gentlemen, good day and welcome to the Q4, FY'13 Results Conference Call of Aarti Industries Limited. As a reminder for the duration of the conference, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference call, you may signal for an operator by pressing "*" and then "0" on your touchtone telephone. Please note this conference is being recorded. I would now like to hand the conference over to Mr. Dhiraj Rajpal. Thank you and over to you, sir.

Dhiraj Rajpal: Thank you and good afternoon everyone. We welcome all of you. Thanks for taking out time for Aarti Industries Limited Analyst and Investor Conference Call for quarter and year-ended March 31, 2013.

To discuss on the performance and financial highlights of Q4 FY13, we have with us today Mr. Rajendra Gogri, Chairman, and Managing Director, Mr. Rashesh Gogri, Vice Chairman, and Managing Director and Mr. Chetan Gandhi, Financial Head.

We will begin this call with opening remarks from the management team following, which we will open the floor for an interactive Q&A session.

Before we begin, I would like to mention that certain statements in this call, maybe forward-looking in nature and a disclaimer to this effect is included in the "Investor Release" and the "Concall Invite", which was sent to you earlier.

I would now like to hand over the floor to Mr. Rajendra Gogri. Thank you and over to you Sir.

Rajendra Gogri: Good afternoon everybody. Thank you for joining us on this call. We shall run you through the operational performance and key highlights for the quarter ended and year ended March 31, 2013. We are pleased to share with you another quarter and annual performance majorly in line with the expectation as has been discussed during the past one year.

As we have stated earlier, we would like to inform you that we have received the requisite consent from Honorable High Court of Mumbai and Gujarat for the proposed Scheme of Arrangement for the demerger of Manufacturing Division of Anushakti Chemicals and Drugs Limited into Aarti Industries Limited. With the completion of regularity formalities on May 7, 2013 the scheme had become effective from its appointed date viz. April 1, 2012. As a result, the related interstate transaction between the companies has been eliminated. Hence to this extent the figure for the previous quarter and year ended March 31, 2012 are not comparable.

Also pursuant to the scheme being effective, Aarti Industries Limited had on May 7, 2013 issued additional 947,16,14 equity shares of Rs.5 each to the shareholder of the Anushakti, thereby the share capital of Aarti has increased by 12% (i.e. from 7.91 crore to 8.85 crore). This restructuring has resulted into the increase in revenue of performance chemical and also has added products with application into polymer, additives and oil and gas additives into our existing range of performance chemicals.

Now coming to the current performance, we are glad to announce that our total revenue for FY'13 has crossed Rs.2,000 crore level and stands at Rs. 2,096 crore. Similarly exports had also crossed Rs. 1,000 crore and aggregated to Rs. 1,059 crore. Hence with this record-breaking performance our exports now constitute over 50% of the total revenue of the company. The EBITDA margin for the company also improved from 14.6% for FY'12 as compared to 17% for FY'13.

Total revenues Q4 FY'13 stood at Rs. 595 crore as compared to Rs. 466 for Q4 FY'12. EBITDA for Q4 FY'13 was at Rs.93 crore as compared to Rs.72 crore in the same period last year. Net profit for Q4 FY'13 was at Rs.47 crore as compared to Rs.39 crore for Q4 FY'12. Annual sales for FY'13 were Rs.2,096 crore v/s Rs.1,673 crore for last year. EBITDA for FY'13 was Rs.356 crore v/s Rs. 245 crore for FY'12. Likewise the PAT for FY'13 was Rs.131 crore v/s 87 crore last year.

Considering this performance the Board of Directors has approved a final dividend of Rs. 1.25 for each equity shares of Rs.5 each. The company had already paid two interim dividends aggregating to Rs. 2.75 for each equity share of Rs. 5 thereby making the total dividend of Rs. 4 per each equity share of FY'13 as compared to Rs.3.5 for each equity share for FY'12.

Friends as you are aware the Company had pioneered by adopting greener hydrogenation prosses based on Swiss Technology in India and have scaled up the capacity to 3,000 tonnes per month in Q3 FY13. This expanded/additional hydrogenation capacity shall help the company to cater to the growing high margin and niche demand in the segment of Polymers, Agrochemicals, etc. in global markets. This shall also facilitate introduction of export-oriented further value added range of products. Hence with this expanded capacity coupled with strong market position, the company expects to post significant growth in revenues and margins in the coming period.

The Company had recorded the production of over 1,550 tonnes per month of hydrogenated products in the quarter ended March 31, 2013. Annual average production for FY'13 was 1,390 tonnes per month as compared to 1,165 tonnes per month for FY'12.

Now I would like to give you key highlights of our segmental performance during the year ended March 31, 2013. Revenue from Performance Chemicals was at Rs. 1,320 crore for FY13 as compared to Rs. 968 crore for FY12. Growth in exports of Pigments, Oil and Fuel Additives and Polymer etc having better margin have been the significant contributing factor behind the growth of the performance Chemical. The segment has posted EBIT margin of over 17.98% for FY13 as compared to 14.65% for FY12.

As informed in the last quarter, the price for our key raw material Benzene in Q4 FY13 has further increased from Rs. 74 per kg to Rs. 82.4 per kg. As you would know in case of some of our exports, we have a quarterly lack for passing on the raw material price, changes to the customer; hence during Q3 the EBITDA is impacted by about Rs.3 crore due to this quarterly lag and the same is being passed on in Q4 FY13. As you would recall in Q1 FY13 we had apprised you that the Japanese Company had officially closed down its production as a result and opportunity had opened up for increasing our presence in the pigment application.

We wish to update that our capacity expansion activity for this product earlier targeted to be completed by March FY13, has been delayed by a couple of months due to delay in the delivery of key equipment by the supplier and it is now expected to be commissioned in the month. Hence we expect further volume growth in these products from Q2 FY'14 so as to meet the demand arising due to this closure.

In Agri Intermediates and Fertilizer segment the total revenue was Rs. 438 crore for FY'13 as compared to Rs. 382 crore for FY'12. Of the above total revenues, the component for fertilizer and nutrient based products (SSP and DCP) for FY13 was Rs. 84 crore as compared to Rs.75 crore for FY'12. The sales of nutrient based product is linked to Indian monsoon and government policy and thus subject to some volatility. However, the other component consisting of products going into various Agrochemicals, herbicides, infecticides, etc., across wider geographies has been witnessing stronger demand and has been growing consistently. The revenue from this range of products was Rs. 354 crore for FY'13 v/s Rs.307 crore for FY'12.

Export for these products was Rs.207 crore as compared to Rs.143 crore for FY'12. In spite of the prevailing drought situation and having lower volumes in first half our sales for SSP for FY13 was around 65,446 metric tonnes as compared to 63,266 metric tonnes of SSP for FY12. While broadly matching our forecast for the year we target to be able to cross the volume of Rs. 90,000 metric tonnes of SSP sales for FY'14. We targeted the volume of products under the Pharmaceutical segment has been consistently increasing, which is resulting into improvement in margins and segmental profitability. The same is evidence from increasing revenue from Rs. 165 crore for FY12 to Rs. 187 crore for FY13. Similarly the EBITDA has also increased to Rs. 9.5 crore v/s Rs .4 crore for FY12.

You would note that EBIT margins have been improving and it has increased to over 5% of sales in FY13 as compared to 2.5% of sales for FY12. Thus as explained earlier also, the incremental growth in revenues result a significant improvement in EBIT. Exports now account for about 50% of the total segmental revenue, an increase of 38% from Rs. 66 crore in FY12 to Rs. 92 crore for FY13. We expect the segment to grow at faster pace in coming years.

Coming to the last segment that is Home & Personal Care segment, the reshuffling of product mix seems to be presenting an improvement in the performance. While the revenue for FY13 was lower by around 5% to Rs.152 crore vis-à-vis Rs.158 crore of FY12. The segmental profit for FY13 was marginally increased to Rs.5 crore v/s Rs.4.9 crore for FY12. The commissioning of the Spray Dryer project in Q4 FY13 and the product reshuffling exercises is expected to improve margins in the coming quarters.

Thus summarizing the annual performance, the Company was recording new heights in its total revenue and export, improvement in operating margins, faster pace growth in pharmaceutical segment, sustained growth in performance in Agrochemical range of products, have been able to close the year with consolidated PAT of Rs. 134 crore v/s Rs. 103 crore for FY12 taking a growth of over 30%. The consolidated EPS of the Company also increased to Rs.15.17 per share in FY13 v/s Rs.13.45 for FY12.

You may also note that with the commissioning of our major key projects that is namely hydrogenation expansion and Pharma debottlenecking in the second half of FY13 and with the expansion of our pigment plant expected to be commissioned in Q1 FY14 the volumes growth from these units significantly add to the performance of the Company in FY14. This brings me to the end of the discussion, and now we shall be able to take the questions.

Moderator: Ladies and gentlemen, we will now begin with the question-and-answer session. We have our first question from the line of Mr. Ramakrishna from Economic Times. Please go ahead.

Ramakrishna: Good evening Sir. Congratulations on a very nice set of numbers. Can you can give us a recap on the expansion plans for FY14? Which of the units are going into production in and which quarters?

Rajendra Gogri: This hydrogenation facility, which was the main commissioning in FY13 should be able to start inching towards the capacity in the month of June. So, the major impact will start coming in from Q2 FY14. Pharmaceutical growth will start impacting from the Q1 FY14 and the pigment plants, which we are commissioning in Q1 FY14 the impact will start coming from Q2 FY14.

Ramakrishna: Apart from these any other expansion plans or any other capacity addition plans?

Rajendra Gogri: We are putting up SSP fertilizer's new plan, but that will be commissioned in Q4 FY14. So, the impact from that will start coming in from FY'15.

Ramakrishna: What is the Capex plan for this year?

Rajendra Gogri: We are still working out in detail on the capex plan, but it will be in the range of around 140 to 150 crore.

Ramakrishna: By way of these three projects, you mentioned the hydrogenation, pigmentation and Pharma, how much additional revenue can these three things bring together?

Rajendra Gogri: We are expecting around 500 crore approximately increase in the revenue.

Ramakrishna: This is assuming all running on full year basis, right?

Rajendra Gogri: That is annual. That is for FY14.

Ramakrishna: When we annualize it will be slightly bigger than this?

Rajendra Gogri: Yes.

Ramakrishna: I just wanted to know what is your debt situation position right now?

Rajendra Gogri: 800 crore.

Ramakrishna: That is on a consolidated basis?

Rajendra Gogri: Yes.

Ramakrishna: In terms of cash, are you carrying any free cash significantly?

Rajendra Gogri: Not significantly.

Ramakrishna: Nothing significant. So entirely debt would be there, and in terms of this Capex that you would be doing 150 crore approximately it will be entirely through the internal accruals or you would be needing any further debt financing?

Rajendra Gogri: This expansion will come internally, but we might need for additional working capital.

Ramakrishna: Total out of this 800 crore how much is the total, basically your investment in working capital is amounting to? How much is locked up?

Rajendra Gogri: Net working capital is about 675 crore.

Ramakrishna: Is there any expectations or is there any work basically going on to reduce it or to bring down the number of days for debtor's?

Rajendra Gogri: Actually our inventory is around 70 days with the increase in volumes. We feel that number should come down. The trade receivable is around about 64 days. I think that might remain towards the debt level, but overall this number which is net working capital is about 102 days should start coming down going forward.

Ramakrishna: In terms of your raw materials basically how far you are exposed to the dollar movement?

Rajendra Gogri: Basically we are about 1000 crore export and most of our raw material are in benzene, sulphur and methanol, which are dollar denominated. So, approximately around 20% of our exports will have an impact of forex rate. As far as imports are concerned, we do not see much big impact, because we are not importing much.

Ramakrishna: In terms of the raw material price fluctuations how far and how fast basically you are able to pass it on to the final customers?

Rajendra Gogri: Generally, in the domestic front, the impact is passed on every month to month and in export there will be about a quarter lag.

Ramakrishna: If there is anything more, I will get back to you later. Thank you Sir.

Moderator: Thank you. We have our next question from the line of Manit Varaiya from Vallum Capital. Please go ahead.

Manit Varaiya: Good afternoon Sir. My question is related to our pharma segment. We have seen a very good growth in the last past two years now in the revenue side and also the PBIT side. I just wanted to get some sense on where our margins could stabilize and what is the strategy going forward in the segment?

Rajendra Gogri: We anticipate to grow in topline at around 22% to 25% in the next year and I think the EBIT margin should come next year we anticipate top be close to 12% to 15% range.

Manit Varaiya: That is on a sustainable margin 12% to 15%?

Rajendra Gogri: It can further go up in the next year because we will anticipate some more approvals in US and Europe for our products. So the margins will grow later.

Manit Varaiya: If you could just throw some light on the strategy which we are going to apply for this kind of a growth rate or targets?

Rajendra Gogri: We have a mix of API and also certain advance intermediaries, which we have started manufacturing for innovators as well as generic companies. These strategies are used to get immediate sales volume. API sales volume takes a little longer time, because it is a four-year cycle from the day we start R&D, we file DMS and the product, the patent gets expired in US and then the sale starts in Europe. So, basically our strategy is say we have a lead time of four years time for API, which we develop every year, the new R&D API, but as well we have a mix of those kinds of products as well as newer projects in advance intermediary where we can immediately get some sales.

Moderator: We have our next question from the line of Jayesh Shah from Mata Securities. Please go ahead.

Jayesh Shah: Sir, you have presently received a merger note from the High Court. So, can you let us know whether the manufacturing unit, what are you going to do with the manufacturing units of Anushakti Chemicals?

Rajendra Gogri: The production of those units will continue.

Jayesh Shah: So, from next time, would we see the revenues coming in from that into the main company?

Rajendra Gogri: Yes. The FY13 numbers are including that Company.

Jayesh Shah: One more thing, the exports now contributes more than 50% to the revenue, so does that mean that you are more focused towards the overseas market?

Rajendra Gogri: Yes, because for most of the product growth in Agrochemical, Polymers, and Additives are more in export market and also pharmaceuticals also our major thrust is on exports, so incrementally, I think, around 60% of the turnover might come from exports.

Jayesh Shah: What about the margins from the exports? Are they better than the domestic businesses?

Rajendra Gogri: It depends on product-to-product. But in general, I would say on an overall picture it would be better.

Jayesh Shah: How do you see the movement from the domestic market?

Rajendra Gogri: Domestic market there is no significant increase in demand like product and textiles or dyes and all that, but pharmaceutical generally remains stable and Home and Personal Care. So there is no significant increase as such in domestic.

Jayesh Shah: Sir, one last question would be what kind of EBITDA margins are you looking for the next year?

Rajendra Gogri: This year we are about 17%. Progressively it has to go up, but the problem is our key raw material Benzene has gone up significantly and that impacts absolute margin increases but the operating margins as such do not increase as much. So, it will depend.

Jayesh Shah: So you expect the raw material by this to go up or do you expect that they will be stable right now?

Rajendra Gogri: If the prices remain where they are right now, the operating margin also can have some little improvement. Prices are very high right now.

Jayesh Shah: Sir, what are your expectations? Do you expect the prices to go up or they would remain at the same level?

Rajendra Gogri: Similar level, I think.

Jayesh Shah: If I have any questions, I will come back.

Moderator: Thank you. We have our next question from the line of Mr. Rajesh Sheth from Tushar Investments. Please go ahead.

Rajesh Sheth: Good afternoon Sir. I just wanted to know the rationale of providing taxation at about 28% from 39% in the last year? You have provided that 52 crore whereas it was 31 crore last time.

Rajendra Gogri: Basically fertilizer is the additional investment we are getting without reduction, and also additional R&D expense is also giving an extra weighted reduction. The power plant also has a scheme where we can get the profit from the power plant under exempt. So these things are additional exemption in various points is reducing the tax.

Rajesh Sheth: Ok. What is the outlook on the Agri Intermediaries for the next year?

Rajendra Gogri: As we mentioned our Agri Intermediaries are mainly on a global level and that demand is continuously growing. So we expect a significant growth there, but domestic also has monsoon is expected to be normal. So we do not see much difficulty in marketing our fertilizer.

Rajesh Sheth: In Global market?

Rajendra Gogri: Fertilizer SSP is in Indian market.

Rajesh Sheth: Thank you.

Moderator: Thank you. We have a question from the line of Mr. Raj Gandhi from Principal Mutual Fund. Please go ahead.

Raj Gandhi: Thanks a lot for the opportunity. Have we done some acquisition in Pharma space recently from domestic company?

Rajendra Gogri: No.

Raj Gandhi: Thanks a lot.

Moderator: Thank you. We have our next question from the line of Nisha Harchekar from Way2Wealth. Please go ahead.

Nisha Harchekar: Sir, I wanted to know what is the production of hydrogenation in terms of tonnes per month in this quarter?

Rajendra Gogri: It was 1,550 tonnes per month.

Nisha Harchekar: What are your expectations for Q1 FY14 and Q2 FY14?

Rajendra Gogri: We should be crossing 2,000 tonnes per month in Q2 FY14, but Q1 FY14 will be similar to this level around 1,500 to 1,600 tonnes.

Moderator: Sir, it seems we do not have any further questions. Would you like to add any closing comments here?

Rajendra Gogri: As we have summarized in our earlier statement the increase in capacities and good potential in export market we are expecting a significant growth in FY14 and FY15 both in topline EBITDA as well as bottomline. Thank you.

Moderator: Thank you Sir. Participants on behalf of Aarti Industries that concludes this conference. Thank you for joining us. You may now disconnect your lines. Thank you.