PI Industries Limited
Q2 & H1 FY20 Earning Conference Call Transcript
October 24, 2019

Moderator: Ladies and gentlemen, good day and welcome to the PI Industries' Q2 & H1 FY20 Earnings Conference Call. As a reminder, all participants' 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, please signal an operator by pressing '*' and then '0' on your touchtone phone. I now hand the conference over to Mr. Siddharth Rangnekar from CDR India. Thank you and over to you, sir.

Siddharth Rangnekar: Thank you. Good afternoon everyone and thank you for joining us on PI Industries' Q2 & H1 FY20 Earnings Conference Call. Joining us today are senior members of the management team including Dr. Raman Ramachandran - Managing Director and CEO, Mr. Mayank Singhal - Executive Vice Chairman and Managing Director, Mr. Rajnish Sarna – Executive Director and Mr. Subhash Anand – Chief Financial Officer.

We will begin with key thoughts from Mr. Mayank Singhal, thereafter we will have Mr. Subhash Anand sharing his views on the financial performance of the Company. After the opening remarks from the management, the forum will be open for any queries that you may have.

A cautionary note: Before we begin, certain statements made or discussed during the call could be forward looking statements and a disclaimer to this effect has been included in the press release shared with you earlier. I would now like to request Mr. Singhal to share his perspectives with you. Thank you and over to you, sir.

Mayank Singhal: Yes, good afternoon to everyone and thank you once again for joining us on this call today. I would first like to start by wishing you all a Happy Diwali which is just around the corner. So, let me now take you through and share our performance for the quarter and the first half.

So, once again, we have reported another great quarter backed by strong performance which is backed by exports. During Q2, we have reported another robust 26% revenue gain and 30% increase in profits and in the first half, we delivered 25% growth in revenue and 27% growth in profitability in-line with our guidelines.

The export business continues to scale new heights. Our innovator customers have been enhancing their requirements for commercializing of new generation molecules and on the other hand, we are also expecting 2 to 3 new molecules to be commercialized. We are witnessing a healthy increase in the inquiries from my innovative partners who choose to engage with us because of our strength in technological and high-end chemistry, innovative process and a sustainable approach in manufacturing. On the other hand, the challenges of China have also given us a boost of inquiries and we hope this will have a positive trajectory to this space.

Now let us focus towards the domestic branded business. While the monsoon have been very good, but there has been an uneven spread of monsoons which has created challenges for the agricultural economy both from the productivity and from a user end of inputs which has actually delivered a softer number compared to expectation for the Agri industry. But given on the other hand, this is going to lead to certain advantages in the coming Rabi season as the reservoirs are at the highest levels in the last 5 years, good level of moisture well spread out through the country. Therefore, Rabi crop is expected to do well. On the other hand, if this weather continues to show its erratic form in the Rabi season, it could pose further challenges for the industry, but for PI, we are very excited to have launched a new generation herbicide which is working well with certain resistant weeds in the Northern part of the country. It is in the early stages of its launch and we still have to go through an experience of taking it to the market to know how well did the acceptance of the new generation product in the farmer's mind. When we look, we have a robust product pipeline in the agri distribution, strong range of inquiries and the partnership with the global innovators are moving ahead as per plans.

Our domestic production of Bispyribac has commenced and contributed further to the development of the NOMINEE brand which has again showed its performance in terms of the acceptance of the quality and the standards of value delivery to the Indian farmer.

Our research in the area of new chemistries and technology is the paramount of us as a Company and it is progressing well to our satisfaction and we see this to play a critical role in the future strategies of PI. The outlook at the present fiscal year is defined with the movement of exports which has been very good in the quarter one, and we expect to keep the momentum for the growth as indicated earlier and the company is expected to deliver a 20%+ growth and order book positions are in a healthy play. So, we are here to see this consistent and predictable growth over the next 2 years as stated earlier.

With this, I would now hand this over to our CFO to continue to take the discussion forward. Thank you, over to you Subhash.

Subhash Anand: Thank you, Mayank and good afternoon everyone. Let me start with sharing financial highlights for Q2 FY20.

During Q2 FY20, revenue was at Rs. 907 crore, representing a growth of 26% over corresponding period of last year. This growth was driven by 52% improvement in exports, going up from Rs. 419 crore to Rs. 639 crore while the domestic operations declined by 12% from Rs. 304 crore to Rs. 269 crore. EBITDA in Q2 came in at Rs. 192 crore, higher by 43% over Q2 of last year with margin holding at 21% despite softness in domestic market. Profit after tax improved by 30% to Rs. 123 crore during this quarter. Effective tax rate was at 27% due to change in SEZ contributions to the overall business.

Let me also quickly take you through the key performance highlight of H1 FY20. In the first half of this fiscal, we have registered a strong revenue growth of 25% to

Rs. 1,661 crore. EBITDA stood at Rs. 343 crore translating to margin of 21%. Profit after tax came at Rs. 224 crore, higher by 27% Y-o-Y basis.

Continued gain in the performance has led to strong operating cash position and a robust balance sheet for the company. Net debt to the equity ratio has remained 0. Cash position at September 30th stood at Rs. 171 crore.

As highlighted in the past, we are seeing visible opportunities and therefore remain confident of delivering 20% plus growth in the financial year 2020 with 50 to 100 basis point improvement in margin. Our current order book position stands at $ 1.4 billion and we have entailed a CAPEX of Rs. 347 crore in FY20 till date. We would be spending close to Rs. 450 crore for the full year FY20.

That concludes my initial remarks and I would now request the moderator to open the forum for Q&A. Thank you.

Moderator: Sure, thank you very much. The first question is from the line of Aditya Jhawar from Investec.

Aditya Jhawar: It would be great if you can help us understand the split of revenue between revenue booked from the order book and spot basis and what has been the trend in the last couple of years?

Mayank Singhal: Well, to be very frank, we don't have the numbers on hand right now, majority revenue is driven by order book position in this business.

Aditya Jhawar: Mayank, you also made a comment that, because of issues in China, we are seeing an increase in revenue coming in, so are these revenues on spot basis or you are seeing increase in supply of existing molecules much higher than the agreed quantity?

Mayank Singhal: No, what I meant, it was not increase in there, but we are seeing the inquiries increase and as you know if you had some business, there is a typical development time which takes about a year to year and a half before we get into commercial supply structure, so that is what I would say.

Aditya Jhawar: And one very fundamental question, what is the gap between order received and commencement of execution and in how much time we will reach the peak**?** For instance, in June quarter, we added about $ 130 million new orders, so when would the execution commence and when would we reach the peak? What is the time gap?

Mayank Singhal: I would say there is no linear answer to that because each product has different timeline, cycle, conclusion and also build outs, also the quantities could be spill over depending on what kind of product, what kind of structure, what kind of inquiries, what volumes and development phase on the regulatory market. So, product to product and that is the way we look at it. Typically, when we look at in order book position, we have been describing this as between 3 to 5 year window for deliveries.

Aditya Jhawar: So, the commencement would be minimum 3 year to commence new execution, is that correct?

Mayank Singhal: That could change from product to product and need to requirement basis.

Aditya Jhawar: And order book seems to have contracted on a Q-on-Q basis?

Subhash Anand: No, we continue to hold to the same level what we communicated last time, it's not changed.

Aditya Jhawar: And since the revenue momentum is pretty strong and we are seeing a very strong visibility, would you guys consider revising your guidance upwards for FY20?

Mayank Singhal: No, as we have mentioned in the past, this business, it is not quarter to quarter base, you should look at this annual base that is based on certain deliveries and depend on the customer needs, the utilization plans, their formulation plans, market situations, deliveries take place accordingly. So, we may have little heavier quarter and we may have a little normal quarter, but we would still keep the guidance as mentioned that is about 20%+ on the revenue front.

Rajnish Sarna: And in any case if you see last fiscal's second half was very heavy. In that sense, the expectation of same product growth level of first half is not a realistic thing because in the second half in any case it will get normalized.

Mayank Singhal: And capacity has also kicked in as mentioned earlier.

Aditya Jhawar: Finally, last question that is for Subhash, what could be our effective tax rate for FY20 and 21?

Subhash Anand: In FY20, we expect to be around 24%, FY21 will be broadly similar number at this point of time.

Moderator: Thank you. The next question is from the line of Saurabh Jain from HSBC.

Saurabh Jain: If you could help us to understand what could be the impact of IND AS 116 in this quarter on the margins?

Subhash Anand: It is similar to what we had last quarter, because its percentage remains same. It is consistent. It won't change quarter on quarter. It is 0.5% what we indicated earlier also.

Saurabh Jain: And also in the press release, it is mentioned that the domestic declined by 12% but if I look at the Y-o-Y numbers assuming of 52% growth in the exports business, the domestic is showing a decline of only 8%, now what is the right number, 12% or 8%?

Subhash Anand: No, it is 12%, I communicated both absolute number as well as total, so it is 12%.

Saurabh Jain: And, I just wanted to understand that, a few quarters back, we made a commentary that in our portfolio only 5 to 6 molecules contribute about 50% of the overall sales in the exports business, is that mix changing now or how is it? It is more bulky or most spread out now?

Mayank Singhal: These are cyclical in nature as new products are coming in and they are ramping up, the pie is changing, so it is hyperbolic pie which keeps moving in different directions and this time obviously the product portfolio is expanding, so revenue percentage will also change across.

Saurabh Jain: That is what I am trying to make sense of, that whether the new molecule that we have commercialized over last 2 or 3 years, are they forming major part of the growth or it is like the conventional portfolio itself is growing by a significant number?

Mayank Singhal: It is the mix of both, because as you see the life cycle of this business is about 10 to 12 years of growth rates for new molecules. And that is the minimum I would say because it till take that time to go to market and all the markets, they still continue to grow and obviously the new and the old both are bucketing together and growing.

Saurabh Jain: But the portfolio is more spread out now vis-à-vis how it would have been a few quarters back? Is that the right understanding?

Mayank Singhal: Yes.

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

Rohan Gupta: My question pertains on CSM business only, that almost from 2 quarters, we are seeing 50% sort of growth that has definitely come after a very long time gap of almost 1-1/2 years in lull period, just wanted to understand little bit more, generally the kind of business in which you are there, you have a very strong visibility of growth of at least 12 months ahead. We had and we anticipated this kind of numbers and 50% sort of growth in the first half or a lot of business has just flown to us because of some lower inventories in the market and then ultimately going to normalize. Because our business is not like it can just jump in a one quarter by 50% and in another quarter, it can come down to 10%, so I wanted to understand more about that.

Mayank Singhal: You are very right in what you are saying and basically we have capacities, so we could produce, delivery is subjective and sometimes the delivery can be taken up in the quarter earlier, quarter later, changes the number, so it is pretty much un-predictable, therefore we still keep the guidance as we mentioned of 20%+.

Rohan Gupta: So, is it like that more deliveries has been just made in the first half and you are still guiding for 20% growth only in the CSM business for full year while we have already achieved that number, I mean it is going to indicate that in second half we will have a flat growth?

Mayank Singhal: No, nobody is saying that. It is not linear, but if you look at it, the growth has been there because one we didn't have, last half year was there, so the next half was very strong, so growing over there mentioned earlier is going to be pretty flat.

Subhash Anand: In fact, if you see H1 of last year, our export growth was roughly around 15 to 16%, so on 15 to 16%, we have grown 52% which is right because we added capacities, H2 was 40% growth and we are not adding any more that large capacity in H2, so we don't expect similar growth to come in H2, so it will not be a similar growth and that is the reason we continue to hold our guidance for the full year.

Rohan Gupta: And also wanted to understand that we must have utilized our plant very efficiently to meet these kind of growth number, I mean 50%, I am sure that our plant didn't have so much of idle capacity that we can meet a growth of 50%, so I just wanted to understand that at current level, the plant which we are operating, I mean this is the maximum utilization you have achieved or there is still any room left or you are over utilizing your plant assets?

Mayank Singhal: I think two facts which were mentioned earlier, one was that we have expanded capacity in the last year which is coming up and showing that performance in the first. Second, this is not a linear plant because it is not a single product plant, it is a multi-product plant which has different value, different capacity, therefore it continues to play in a certain band. So, I would not say that we are ramping up utilization, maybe seen at the same level, sure it is running at a satisfactory level of utilization and good product mix which has come up, to give us this performance.

Rohan Gupta: Sorry to once again harping on the same issue again, so you are talking about 20% growth on the last year number of roughly Rs. 1,868 crore revenue in CSM, if you apply that number it means that the second half we are guiding zero growth, so just wanted to understand that are we just being bit more conservative or you see that in the second half, there can be some challenges?

Subhash Anand: No, let me reiterate, when we say 20% growth, we are talking blended growth, not CSM growth but for the company.

Rohan Gupta: But in initial remarks you have been mentioning that it will be similar from domestic as well as CSM both?

Mayank Singhal: Domestic is not shaping up, that was expected.

Rohan Gupta: Now you are seeing the loss of domestic growth is now going to be compensated from the higher growth in CSM and that is why, maybe we can still see some growth in CSM in second half as well?

Mayank Singhal: Some growth, yes.

Rohan Gupta: Just one more question and I will come back in queue, when we operated our plant which is so efficient with 50% revenue growth, isn't it that it should have also shown higher margins because we would have benefited from operating leverage, our margins must have gone up significantly, so just only by simple accounting principle and higher utilization level but it is not reflected?

Subhash Anand: It is reflected, if you see the results, margin has gone up and primarily if you see the leveraging has come in since we have grown.

Mayank Singhal: If you see the last quarter, it was 18.6% EBITDA, this quarter it is 21%, so obviously the margin expansion is reflected in that growth.

Moderator: Thank you. The next question is from the line of Bharat Shah from ASK Group.

Bharat Shah: I had 2 questions, what has been the operational cash flow generated in the second quarter and for the first half and secondly what has been the return on capital employed for this quarter?

Subhash Anand: On cash flow, if you see our positive cash flow or cumulative cash flow surplus is Rs. 171 crore. This is in spite of CAPEX of Rs. 347 crore, so definitely there is a cash generation which has happened in this quarter.

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

Amar Mourya: My question is primarily from the domestic outlook point of view, now given that the Rabi looks decent for other peers and there are few new products which are going to be launched, so what is the outlook for domestic operations for the second half?

Mayank Singhal: The outlook is positive given the weather situation, compared to the first half, but again depending on the erraticity of the rainfall as there can be too much of rain as we have seen in the first half, but clearly we see a positive trend for Rabi and given the Southern peninsula of India which is going to definitely give us some positive uptick and on the other hand, we have also launched a new product in the Northern markets in crops like wheat.

Rajesh Kothari: This is Rajesh Kothari here. My one more question is, with next 3 to 5 years in view considering that we are doing significant CAPEX, we have also acquired one company recently, how do you see over next 3 to 5 years, the entire story panning out from the innovator's perspective, from ramp up perspective, as you mentioned in your opening remarks that there are number of molecules which are going for commercialization stage, so how big the opportunity can be?

Mayank Singhal: Well definitely as we have stated earlier, we are looking at 20%+ growth over the next 3 years on a year-to-year basis and this is definitely based on certain estimates of looking at our existing pipelines, various stages of commercialization and in order to extrapolate and ensure that we are able to do that effectively, the acquisition of capacities as you mentioned for Isagro and other development investments are based on certain dependencies on these backed up orders and commitments that we see we will be able to move up, so we definitely see this growth rate of 20%+ over the next 3 years.

Rajesh Kothari: This 20% CAGR what we are talking about, that assumes how much domestic CAGR and how much export CAGR?

Mayank Singhal: That will be depending on year to year basis. Basically we have to look at this CAGR on equally split basis going forward from here. Obviously in both the businesses, the season does have a role to play, one is in the global seasonal patterns and the local seasonal patterns and somewhere they do even up from my experience in this business for the last 20 odd years, in the mix portfolio of exports and domestic market, so that is why we have estimated that number.

Rajesh Kothari: But don't you think that the commercialization of the different molecules gives you more visibility in terms of CAGR and generally speaking it can't be even right? That's a different way to look at it but from your business plan perspective, your CAPEX perspective and your customer innovation perspective, it can't be just matching 20:20 for both the segments.

Mayank Singhal: It is not 20:20, even in distribution obviously the scales of this businesses are different, but that is what we have done as an estimate as a business plan. I don't have the exact numbers for the next 3 years in front of me but clearly what we have done is that the business will look at 20% growth at a mix portfolio.

Rajnish Sarna: Basically, as a matter of fact both the segments have almost equal opportunity while in export business, there is clear visibility of order book and the products getting commercialized. At the same time, we also have pipeline of new registrations happening in domestic market and also the scaleup plans of the products which we have already launched. So, there are equal opportunities.

I think the point being made is that we have taken on a blended basis a growth objective of 20% plus. Basis our past experience, we are always seeing that our business model is helping us. If a domestic is not doing fine, we have seen that the export business has been able to match it up. That is what we are seeing in the first half and we have also seen few years where the suppliers were not picking up and the domestic did well and we could still manage the growth as such, so that is what we are trying to explain that given the visibility on both sides, we are pretty confident that we should be able to manage and maintain this 20% growth momentum.

Mayank Singhal: And on the other hand, the domestic business is single geography based and the export business multi-geography based, so that is how this all will come.

Dr. R. Ramachandran: I think on the domestic side, the variables that we deal with are much more. There is weather, there is acreages that is planted, there is demand that comes out, it depends on weather and crop and I think that is one factor to consider when you think about how we balance these two businesses.

Rajesh Kothari: So, from the incremental CAPEX perspective, between two markets, between domestic and export market, will you be focusing on export side?

Mayank Singhal: Domestic business is of partnership and distribution that has hardly any CAPEX

Dr. R. Ramachandran: So, the typical success factors for both these businesses are very different, one is about product development, marketing, licensing the right product for Indian government whereas the other is all about putting the assets at the right time and sweating the assets.

Rajesh Kothari: And one last question from my side is, how do you see the raw material prices because the China raw material prices are reducing significantly. That is what we understand, how do you see the trends on the raw material side?

Mayank Singhal: Obviously, as you see the raw material side, there is volatility and availability challenges, but PI has taken a proactive stand over the last 2 years, to de-risk itself and having alternative supply structures which has helped us to offer a sustainable supply position to our customers and we have been able to develop vendors. Price volatility does exist where the reduction in volatility is also the trend we are seeing, so we do not see that as high risk today for the company and we continue to manage that well.

Moderator: Thank you. The next question is from the line of Abhijit Akella from IIFL.

Abhijit Akella: First I just wanted to get your thoughts on the domestic business, we probably registered a sales decline of somewhere around 12% odd in the first half, how would you believe that compares with the industry's Kharif performance and whether you believe you might have lost a little bit of market share?

Mayank Singhal: No, I won't say that we have lost the market share but clearly yes, our performance is definitely not among the top in the industry for the first half. We were at the bottom of the pie but clearly our focused areas of our critical molecules, I would happily say that we have been able to retain if not grow the market share. Of which some of the segments where we do play, there has been a severe weather impact which has created an impact on our revenue there followed with money tightness which we have been able to counter, which has given us a better cash out of the business and us having been in a better working capital situation, which has also given us the strength to leverage going into the next level.

Dr. R. Ramachandran: So, just to supplement, I think it is also to some extent that conscious effort because we realize that liquidity in the market is very tight and hence our focus has been to be a little bit more careful about how we place our products and focus more on the collections and ensure POG (Product on Ground) rather than just revenues**.**

Abhijit Akella: In terms of the segments that you mentioned where you face some pressures, examples like soybean be one example of that? I mean floods in Madhya Pradesh etc.

Dr. R. Ramachandran : So, Soybean is not a major focus crop. Rice and corn and fruits and vegetables tend to be our even more major focus crops and cotton. And overall, what has happened is that we had a delayed monsoon and consequently, many farmers resorted to shorter duration kind of varieties and crops and then you saw that there was continuous rain and this spilled over to September which all generally reduced the pest pressure on crops as well. So, the highlight has been one of our flagship products as you know is 'NOMINEE GOLD'. This has been under pressure from some of the generic players, there are almost 50 brands, but in spite of that, we have actually been able to increase our product on ground and volumes substantially but of course there was a little bit of price pressure on this because of the number of generics and at this point, our focus is to retain the majority molecule share with our brand and I believe we have achieved that and we are very happy with that achievement.

And in cotton, we have our flagship product 'OSHEEN' which is another product which has actually marginally grown on a product on ground basis. So, I would say these are the two positive things and which was specifically our goals for this Kharif season.

Abhijit Akella: Appreciate the colour, I would love to get your thoughts on the opportunity for Pyroxasulfone, the new herbicide you are launching, any way to size up the overall opportunity size for that molecule?

Dr. R. Ramachandran: So, I would not venture to give you a guess about the opportunity size because it is a new molecule, it is a product that needs to be used very differently from what the farmers are used to. It is versatile product; it is not an easy product to sell. We are launching it in wheat for one of the resistant weed controls. So, we will not be able to give you a good estimate at this point, maybe in 3 or 4 months' time when you have the first season, we will be able to give you a better feel for what this product is likely to be.

Abhijit Akella: We have seen the effective tax rate actually in H1 is about 26% and we are talking about 24% for the full year. So, does that mean the CSM revenue mix will shift in the second half towards the SEZ and how do we decide which facility to use? Does it depend on the variable capacities or is there some other criteria on that you use?

Subhash Anand: So, it is basically a capacity, where we have a capacity and how we can leverage that and that is how the effective tax rate comes in. So, this quarter since overall revenue shift was more outside SEZ, so the effective tax rate going up. So, we see that to be getting normalized.

Moderator: Thank you. The next question is from the line of Ritesh Gupta from Ambit Capital.

Ritesh Gupta: Just on the CSM bit, the growth guidance that you are giving probably more like flattish to probably a high-single digit to mid-single digit sort of growth rate, second half primarily on account of base, the sense I got is that your commissioning a new multipurpose plant and then the new acquisition capacities etc. also come into picture in quarter 3 plus I think in the last quarter you had alluded that you have been facing some bit of supply constraints as well and I think if I remember right, Mr. Sarna also made a comment that growth actually could be heavier on the second half side, so is there a change what is that we are missing here because I think if capacities have been constrained in the first half and if more capacities are coming up in the second half, ideally the growth should have been higher, right? And second half tends to be relatively heavy base for you always, I think the same was there in FY18 as well.

Mayank Singhal: So, let me correct. Number one, capacities that kicked in the first half give us the revenues in the second half last year. So therefore we are continuing to deliver the revenue in the first half. So, now that is the capacity which was there in the second half with the revenue which has got added in the first half.

Now in the second half, we are commencing some additional capacity, but does not mean it is going to give us any substantial revenue as we start up. Secondly, the integration is still to happen. So, that cannot be still added as a capacity revenue, in any capacity which we do integrate we will have to turn it up, putting together to work for us will take about a year, year and a half and that is really what it takes. So, that is where we are.

Ritesh Gupta: Okay. And the new molecule commissioning etc. will also give you benefit only in the first half of next year.

Mayank Singhal: Well, I would not say first half of next year, it could take quarter or two depends on the molecules and the structures, but nothing just kick starts as you would appreciate in the large plants and products because initial supplies and scaleup take their own time. But that is just to get built up earlier.

Ritesh Gupta: Got it. And is there any order book number that you shared in the call?

Subhash Anand: We have maintained the same order book number.

Mayank Singhal: Same as the last quarter.

Ritesh Gupta: And just on the margins bit. I think you said that margins had some scaleup cost also built into it. I think the press release again mentions that. Plus, I think the gross margins have been under pressure. This quarter also, there has been a 50-bps decline and typically we have seen that CSM tends to benefit the gross margins overall. So, is it that the China pressure is still kind of persisting on the gross margin side or do you think that gross margins are already normalized?

Mayank Singhal: We are not linear to the China situation as you know we have pass on structures. So, obviously, the cost of raw material is going up, it is not something that we are getting higher margins for it. So, therefore the ratio will change but the consistency in our run-up remains there and obviously, volatility is there on the raw materials front.

Subhash Anand: And gross margins do change based on the business mix and product mix what we have.

Rajnish Sarna: The operating margin benefits are surely kicking in as we were explaining to the earlier participant. So, if you see for quarter 2, there is more than 2.5% of operating margin which is kicking in and overall for the first half, it is almost more than 1% or so. So, those benefits are certainly kicking in.

Ritesh Gupta: And just a last bit. I think global agri market continues to remain not so in a buoyant mood as such and from that perspective, I think when I see your growth rates, are they more driven by market share gains or let us say new molecule coming into your side or is there some inventory pent up which one of the earlier participants also alluded to. So, is it something which you are seeing because of new molecule introduction or market share gains or is it something which is more of an inventory catch up and that makes us let us say in a year or two from here.

Mayank Singhal: So, if you look at the $85 billion global market, we are not significant enough to really get impacted by the large play, but on the other hand, the areas that we have chosen to play do have a consistent performance of growth, both from the selection and the play with the customer that we have. So, therefore at this scale and stage, definitely gives us the consistency and once we do get to the part where our contribution as percentage does have a play. And the innovator products as you will always see will continue to grow and geographies expand, regulatory registration takes place and customers are always looking for better replacement for the generics. So, that is the consistency in this segment.

Moderator: Thank you. The next question is from the line of Vishnu Kumar from Spark Capital.

Vishnu Kumar: This question is for Mr. Subhash, if you could just explain the capitalization in the first half in the gross block?

Subhash Anand: Okay. Our capitalization for first half is Rs. 337 crore.

Vishnu Kumar: CWIP shows about Rs. 250 crore and in the asset block it looks like we have only capitalized is Rs. 90 crore. But the put together what you are saying is right, but the only capital is about Rs. 90 odd crore at the gross level.

Subhash Anand: Okay. You are talking capitalized. The number which I say is including CWIP because finally this we put on the asset and capitalization, commissioning yet to happen but yes, investment has happened.

Vishnu Kumar: But in the first half, if the calendar year, how many plants have we kind of started or is it likely to start in this calendar year and also if you could let us know when we start the next couple of plants?

Subhash Anand: Okay. We have one plant commissioned in Q4 of last year, in Feb that is where we completed in this calendar year if we talk. So, one, we are expecting to start now any time and we also expect one more plant, sometime in Q4 of this year.

Vishnu Kumar: So, one was started this quarter last year, that is December 2018. The next one we are going to start in this quarter and the third one will start in March 20, third quarter?

Rajnish Sarna: Correct. Yes, broadly. The first one was in January-February.

Mayank Singhal: Yeah. February 2019.

Vishnu Kumar: Yeah. Jan-Feb, got it. And just wanted to understand the new set of plants that are coming up, are there any other applications or product profiles that you can move into; say specialty chemicals, pharma and not just of agro. Are we slightly diverging into or are we seeing more customers ask for slightly differentiated molecules?

Mayank Singhal: We are functioning in the same space at the moment as we do see a good opportunity and would like to maintain the scale of growth in those areas while we are evaluating certain products at a smaller scale, commercial scale in the other area of application for which we would see the next couple of years, some potential to be visible.

Rajnish Sarna: One plant is in the building block of MMH, which will help us get to other areas as well.

Mayank Singhal: Of building capability of other products.

Vishnu Kumar: MMH is the one that is going to start this quarter, I mean the one that is going to start up now. Is that right?

Subhash Anand: Yes. That is right, Vishnu.

Vishnu Kumar: Got it and if you could just let us know the CAPEX for next year, FY21?

Mayank Singhal: We are about Rs. 300-400 crore. That is what we are looking at right now.

Subhash Anand: It will be in the range of around Rs. 300 crore, I would call it.

Vishnu Kumar: And just one final question here. You had changed your accounting policy where we technically can, if you produce for a certain customer, we can technically account it even if it has not left the factory, is the number pretty high this quarter or is it largely very negligible. If you could give some color on that?

Subhash Anand: No. Vishnu, in fact number, it remains broadly similar from quarter-to-quarter. In fact, there is not much variation what we have seen in March number, June number and even in September number. So, it is broadly remaining at same level.

Vishnu Kumar: Should be around Rs. 30-50 crore or less?

Subhash Anand: Yeah. Broadly around in the same range, I would call it.

Moderator: Thank you. The next question is from the line of Chirag Dagli from HDFC Asset Management.

Chirag Dagli: This new CAPEX that you are doing, does it have more sales potential because it is at the existing capacity, the rest of the infrastructure etc. has just built in. So, versus your current asset turns, will this CAPEX deliver more sales?

Mayank Singhal: No. It is not a linear way to look at it and I think it is just a mix of it because you are building capacities, not just reactors, but also infrastructure that comes along with it.

Chirag Dagli: And just more on strategy. So, you are guiding to a solid growth in CSM next few years. You know, once we reach $450 million-$500 million, we will be amongst the largest custom synthesis in Agchem at least. Where do we go from there and how should we think about growth post that number, post you achieving that number, because the action for that needs to be done today. So, how are you thinking about post achieving that large number. How does one drive growth from there on?

Mayank Singhal: So, I will have to answer that in a diplomatic way, because strategies need to be held close to the chest. These are the same questions I remember coming to me 3 years ago, the market size, opportunity, but as the pie is decent and the concepts are changing and the way we are working to look at other areas of technology block, I do not see even a shortage in the Agchem space which will be also shifting. And the opportunity that itself would become a larger play and you can overall get the rest and if you get a better understanding of global picture of this place and clearly, in my view this market will continue to expand at least for the next 5 to 7 years without a doubt at the same pace and on the other hand, PI is looking at some innovative approaches to continue with its expansion growth both from a revenue and by offering technological advancement in other areas of application.

Chirag Dagli: So, nothing substantial needs to be done in the next 2-3 years.

Mayank Singhal: We just need to execute our order books.

Rajnish Sarna: Just to add to this, in terms of what you mentioned is right, but you know as a matter of fact for the last several years, we have been also working on technologies which will give us footprints in other verticals. So, it takes time, but in next 3 to 5 years and we reach to that stage, we will have certainly many other opportunities in other verticals, other than Agchem.

Moderator: Thank you. The next question is from the line of Madanagopal Ramu from Sundaram Mutual Fund.

Madanagopal Ramu: Just wanted some more clarity on the CAPEX front. So, the capital work in progress is Rs. 450 crore. So, for the plant which is coming up in this quarter and for Q4, what is the pending CAPEX?

Subhash Anand: Okay. This year guidance, if you see we have said we will be spending Rs. 450 crore plus CAPEX this year. Out of that, we have already spend Rs. 347 crore. So, balance yet to spend.

Madanagopal Ramu: Okay. So, it remains the same, Rs. 450 crore target for the year. And you said next year Rs. 300 crore CAPEX, the run rate of cash generation in the first quarter if I sort of look at the same for the first half, if I take it for the second half, then Rs. 800 crore would be probably close to cash generation from operation after tax. Next year also probably you might be closer to Rs. 900 crore. So, there would be a surplus of close to Rs. 400 crore- Rs. 500 crore getting generated. Correct me if I am wrong, what would be the plans for it?

Subhash Anand: If you see, we are in investment mode, we have just announced an acquisition. So, we are in investment and spending cash. So, in next few years we will generate cash and we will be deploying cash back in the business. So, that is where we see ourselves at least for next couple of years.

Madanagopal Ramu: So, the next year Rs. 300 crore, you are saying there is a possibility of that going up or additional acquisition sort of opportunity.

Mayank Singhal: We don't want to get into a forward looking statement.

Madanagopal Ramu: But you are planning to deploy it back into the business?

Mayank Singhal: Yes

Moderator: Thank you. The next question is from the line of Tejas Sheth from Nippon India.

Tejas Sheth: Just one question, on the opening remarks, you mentioned about increased number of inquiries because of the China issue. How different are these inquiries in terms of size, in terms of tenure, or in terms of chemistry. Are they very different, does more faith now lie with the Indian manufacturers where the global sourcing companies looking for a different output from the Indian manufacturers?

Mayank Singhal: So, I would not call that a China issue. Obviously, there are many strategic shifts which are taking place in the agri space and one of them being the M&A. But clearly the size and chemistry**,** I think the message is very clear, Indian chemical industry looks to be more sustainable. Indian governance structures from the Government point, the regulator is also pretty good and I would say that from the environment point, the country has been strong, much strong and it is getting even stronger than before which overall is very good. It is a little pain for the industry, but it is good to go through that and it is a positivity creating sustainability in the chemical world, and for India to become a large chemical player in this space.

So, looking at all this, they definitely see India as a positive playground for putting up chemical industry and partnering with chemical partners who have cut the same value structures which are fitting in because the couple of extra dollars here and there have been very clearly noted is not the value proposition that large global companies are looking to put their risk of revenue and credibility.

Tejas Sheth: Now we have a credible history of let us say 3-4 years of delivering some large projects, has the size of project or size of inquiries really increased multifold for a single molecule or are they still trying and testing us at the global level as a manufacturing hub or manufacturing company for PI in specific?

Mayank Singhal: You cannot define that by size i.e. large scale. I think the complexities and the scale is dependent at some of these molecules in the early stage. Obviously, for us we know the potentials and the only advantage PI has at this stage compared to any of its competitors is the understanding in the agri space and the distribution network and understating of how the crop systems work. So, we definitely are able to understand how some of these products that we look at an evaluation stage does make sense going forward.

Tejas Sheth: So, they are ready to take more risk with us and replace China wherever it is possible per se in terms of size at least, because every time when we have this question, they say China has the scale and Indian manufacturers do not have the scale. So, I just wanted to understand from that perspective?

Mayank Singhal: I do not know about this statement because I do not know about the CSM space where China has scale, but again I think where that statement would be coming from is basically from the raw material space, not from the CSM or technology space which is what the new generation products are all about, not about the raw material structures. Similarly with the old generation products, they will be dependent on large scale raw materials and couple of things like that. New generation is about 14-15 processing tests to get to that product.

Moderator: Thank you. The next question is from the line of Vihang Subramanium from Samsung Asset Management Company.

Vihang S: Just one quick thing like there has been some news about some of the innovators like Bayer etc. being in financial stress and they are talking about streamlining R&D budgets etc. So, do you think that is a long term risk for your business like for instance the innovators cut down on R&D spends meaningfully?

Mayank Singhal: The large companies only survive on innovation. So, cutting them must be to optimize that, it does not mean they are not going to innovate because the DNA is innovation and with M&A the objective is to get more efficient and to come out with bigger structures to deliver greater value. So, I see this as an opportunity and having spent the money on acquisition of products, they will definitely look for partners who could support them and spend building up assets and deliver products. So, I will look at it in a different context.

Vihang S: And, you just spoke a while back about some other chemistries and some of the work which have been doing which will kind of give you long-term benefit and like 2 to 3 years, so if it is possible, could you provide like some more qualitative details on the progress that has been done?

Mayank Singhal: Frankly, as you understand innovation and strategy needs to be held close to the chest. What I can say is that we are looking at some innovative process technology capabilities which PI is best known for, to support our customers by bringing some innovative solutions.

Moderator: Thank you. The next question is from the line of Varshit Shah from Emkay Global.

Varshit Shah: My question is more of a follow-up with the previous question from the participant. So, considering the China factor, you mentioned that it was more heavy on the raw material side and now the new edge is more of about technology. So, is it correct that is due to this that we see higher input cost because the raw material supplies would disrupt other than the technology itself and hence this is more of a permanent disruption rather than cyclical one or temporary one? Is this the right way to assess it?

Mayank Singhal: Well, I do not know what you mean by disruption in raw material, not disruption in technology. But I guess, yes, now if they have to move into the quality of raw material supplies like anywhere else including India, sustainability is going to be a key part and obviously it is going to put up the bucket in terms of cost structures. So, this is raw material and obviously, raw materials have higher CAPEX, kind of approach, you will see as a fixed trend where you would see a change in the base of raw material prices.

Rajnish Sarna: And to clarify on this point that yes, the Chinese situation is generating a lot of opportunities in chemical manufacturing from raw material, to intermediates to AI. But PI is still continuing with their CSM business of being in high value, a low volume business and complex chemistry. So, given the Chinese situation, we are not changing our business model just to clarify.

Varshit Shah: I actually understand that strategy of yours. What I am trying to say is that due to this change at the China level, I think some of these raw materials which PI may not be using at all to that extent, but may not be into that particular molecules, but the increase in prices or which has happened, although they would have moderated from peaks, but I think those prices might not go back to historical levels.

Rajnish Sarna: That is true because their overall environment management cost, transportation cost, labor cost have certainly increased and the currency is also appreciating both these assets are getting factored.

Moderator: Thank you. The next question is from the line of Prashant Tiwari from SBI Capital.

Prashant Tiwari: What I wanted to understand is the difference in the gross margins, the decline in gross margins given that we have expanded our share of CSM revenues. Is not CSM higher gross margin business and if that share is increased, the gross margins should have increased that way?

Subhash Anand: No, in fact it is not the same way and that is what we in fact communicated earlier also. Gross margin also has a dependence on product mix as well as business mix. So, it is not completely linear that doing more CSM will certainly give more margin or not that is not the case. It has product mix as well as business mix as a part of this. So, both play an equal role.

Mayank Singhal: So, the balance between margin capacity, capital efficiency and various factors which come together to create that.

Prashant Tiwari: So, even sequentially, we had an adverse raw material kind of push, but we have made up by increasing our efficiencies, right?

Mayank Singhal: You can say that because we have different business model for different products and raw material prices to get pushed up while we continue to maintain our margins of what we have agreed in terms of deal structure that we have.

Prashant Tiwari: And also on this export incentive, we typically have around Rs. 50 crore of MEIS incentive that we get in a year. Last year, we got Rs. 47 crore. So, what are your thoughts on discontinuance of it in the coming year, maybe after March it will be discontinued or so?

Subhash Anand: We need to understand that. So far there is nothing, no policy on that. Government is still looking to incentivize export, and this is one of the large export incentives.

Rajnish Sarna: It would be product based, but we have so far, I do not think we have heard of this incentive going away on the chemical industry or category of products. In fact, it is other way around that what we hear like Government is considering for additional incentives to boost the export.

Prashant Tiwari: And what is the percentage rate on exports that we get in terms of MEIS incentives?

Rajnish Sarna: 2% in certain category.

Moderator: Thank you. We will take that as the last question. I would now like to hand the conference back to the management team for closing comments.

Mayank Singhal: Thank you everyone for coming and thanks for all the support and once again from PI, we wish you all a very Happy Diwali and a Prosperous New Year to all of you and your family. Thank you.

Moderator: Thank you very much. On behalf of PI Industries that concludes the conference. Thank you for joining us, ladies and gentlemen. You may now disconnect your lines.
