PI Industries Limited

Q4 & FY2018 Earnings Conference Call Transcript

May 18, 2018

Moderator Ladies and Gentlemen, Good Day and Welcome to the Q4 & FY2018 Earnings Conference Call of PI Industries Limited. 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 call, please signal an operator by entering "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Nishid Solanki from CDR India. Thank you and over to you, sir.

Nishid Solanki Thank you. Good evening, everyone and thank you for joining us on PI Industries Q4 & FY2018 Earnings Conference Call. Today, we are joined by senior members of the management team, including Mr. Mayank Singhal – Managing Director and CEO, Mr. Rajnish Sarna – Executive Director and Mr. Subhash Anand - Chief Financial Officer. We will begin the call with opening remarks from the management team followed by an interactive question and answer session.

At the outset, I would like to clarify that certain statements made or discussed on the conference call today may be forward-looking in nature and a disclaimer to this effect has been included in the results release sent to you earlier.

I would now like to invite Mr. Mayank Singhal to share his perspectives. Thank you, and over to you, sir.

Mayank Singhal Thank you. Good evening everyone and a very warm welcome to PI Industries' annual conference call.

For FY2018, it has been a mixed bag of performance for us. On one hand, despite having a solid business visibility, we have ended the year with a subdued and below expectation performance mainly on account of execution challenges posed by external and also certain internal factors. The good part, however, is that business is just delayed and not lost.

In the first-half, we faced challenges in key cropping regions, getting uneven rainfalls, freak incidences of adverse weather, after effect of demonetization and GST implementation, weak demand scenario of global Agchem industry, slowing the export shipments. The overall scenario, however, substantially improved in the second-half, the demand uptick in exports, significant improvement in inquiry flows, and launch of new products in the domestic market. However, the basic raw material supply challenges from China, some logistical challenges, issues with ports and timely execution resulted in delayed deliveries.

During the current year, we have introduced five new products in the domestic markets which were received well by the farmers and did better than what we initially expected. We also commercialized four new molecules for exports which have significant potential to grow in the coming years and we can drive comfort from a significant increase in both the new inquiries and scale-up pipelines.

In the domestic business, we are taking solution centric approach, engaging closely with farmers with focus of addressing their key issues. With the aid of digital initiatives and application technologies, we are interacting on a real-time basis in order to bring best farm practices to the fore. A similar campaign is in place for our retailers where we are seeking to streamline distribution processes.

On the technology side, we are focusing to extend our business palette beyond the existing competencies. We have augmented our world-class R&D capabilities and doubled our R&D expenses over last year at Udaipur facility and expect R&D to significantly contribute to future growth of the Company. We will continue to invest in building and expanding our R&D capabilities, technologies, building blocks and innovations. As we look beyond agchem, the opportunity really opens up wider. Over the next couple of years, we hope to have a portfolio of such export oriented products.

Our outlook for 2019 will be outlined by scale-up of newly commercialized products, expansion, addition of new capacities in Jambusar that will allow us to plan and ramp up against orders in-hand. The normalized monsoon expected during 2019 will set the stage for future launches of brands and with an objective to continue to broaden and deepen the product portfolio to expand our presence in key crops. We will be launching another four products to five products in the coming year.

I would now like to call upon our CFO – Mr. Subhash Anand, to take you through the financial highlights. Thank you.

Subhash Anand Thank you Mayank and Good evening everyone. I will share the key financial performance for the quarter and year ended March 31, 2018.

In Q4 FY18, our total revenues came at Rs. 625 crore, higher by 3.2% year-on-year, driven by 10.4% improvement in the domestic sales and 0.4% growth in exports. EBITDA stood at Rs. 135 crore, translating to EBITDA margin of 21.5%. This stood in-line with product mix and higher costs attributed to raw materials. Profit after Tax stood at Rs. 105 crore, lower due to higher effective tax rate Vs. last year.

In FY2018, our total revenues stood at Rs. 2,277 crore, almost flat Vs. previous year due to subdued momentum in the domestic market owing to unfavorable monsoons, effects of demonetization and initial disruption from the GST implementation. Total domestic revenues stood at Rs. 822 crore, 1.9% lower Compared to previous year. On export front, full year revenue was at Rs. 1,455 crore, 1.2% higher Vs. previous year. First half shipments were impacted due to softness in global demand resulting in de-growth. However, there was a visible improvement in export shipments towards second half. EBITDA came in at Rs. 492 crore with margin of 21.6% as guided in the past. Profit After Tax stood at Rs. 367 crore. Effective tax rate of 20.9% in FY18 Vs. last year which was much lower because of certain withdrawal of abatement that we had.

Moving to our balance sheet position, our total debt as on March 31, 2018 stood at Rs. 83 crore translating into Debt : Equity ratio of 0.02x. Our balance sheet continues to remain strong supported by stable cash flow generation. As on 31st March, 2018, the available cash surplus stood at Rs. 280 crore.

Our Board of Directors has recommended a dividend Rs. 2.50 per equity share of face value of Rs. 1 each. With this, the total dividend for the year stood at 400%, i.e. Rs. 4.0 per equity share.

With that, I would now request the moderator to open the forum for question and answers. Thank you.

Moderator Thank you, sir. Ladies and Gentlemen, we will now begin with the question and answer session. We have the first question from the line of Pratik Poddar from ICICI Prudential MF. Please go ahead.

Pratik Poddar I just wanted a clarification that the delay in shipments was because of logistical issues at our end or at the customer's end?

Rajnish Sarna No, these were the logistical issues at our end and the customer demand, purchase orders were all in place and in fact materials were also dispatched from our side, but it is all due to congestion at ports and the shipment of vessels and their timing and all. So, these were the reasons.

Pratik Poddar So, the growth in industry is very much there, it is not as the growth in the industry not there. Especially in the first-half of this financial year, the demand was not that strong. Fair enough to say that the demand at least has started improving and quarter-after-quarter we can see a sequential recovery in demand?

Rajnish Sarna Yes, certainly, as we have indicated that the global industry demand scenario has also substantially improved. I mean, it is showing a clear trend which is also reflecting in these Global company's results as well and this is also reflecting in the order flow from these companies.

Pratik Poddar So FY2019 would definitely be better than what we had seen I mean, Q4 FY 2018, right? Adjusted for the issues of logistics also, so even if there is one issue because of which the sales have got deferred to the next quarter. Hypothetically, assuming they were booked in this quarter itself, still fair enough to say that we would see a decent recovery come FY2019?

Rajnish Sarna Yes, this is what we are expecting.

Pratik Poddar And just one small question. You talked about in the opening remarks about some raw material shortage from China, what was that about?

Rajnish Sarna Yes, so basically as we have mentioned that despite having close to 10% growth kind of business with us, we still ended up with subdued or flat performance and the key reasons were basically some of these raw material supply challenges coming from China because the Chinese chemical industry is undergoing some consolidation phase and some such challenges and plus some of these logistical issues that we explained.

Moderator We have the next question from the line of Sumant Kumar from Motilal Oswal. Please go ahead.

Sumant Kumar What is the sales growth and EBITDA margin guidance for FY2019?

Mayank Singhal We are looking at a sales growth of about 18% to 20% overall for the company and EBITDA margins will be around 21%.

Sumant Kumar Can we expect a little bit better from FY2018?

Subhash Anand It will actually be almost the same level of FY2018.

Sumant Kumar When we are expecting better sales in CSM, so we can expect margin expansion because of economies of scales?

Subhash Anand In fact, the sales growth what we are expecting next year, we are expecting both businesses to do well. We are not saying one business will do far better than other business no. We expect both businesses to contribute, so margins trajectory will remain broadly at the same level where we are currently.

Rajnish Sarna And secondly, we are also accounting for lot of capacity bottlenecking, introduction of new molecules and investment in their promotions. Also, commercialization of new products at the CSM scale, and also continued with our R&D investment. So considering all these sectors, we are expecting to maintain and sustain the kind of EBITDA margins that we have currently running. And by continuously increasing the volumes and the values, we expect to grow EBITDA on operating leverage.

Sumant Kumar Okay. So what is your view on the raw material side and the availability from China, so the raw material cost will be higher or will moderate from here?

Rajnish Sarna I am not very clear of your question but obviously, if raw material availability and the overall scenario is improving, the prices will only come down or normalize.

Sumant Kumar Okay. So, in that case, if the raw material price is going to soften, than there is a possibility of margin expansion in domestic as well as a global market?

Rajnish Sarna Yes. But we certainly do not account for factoring these speculative things in our projections and forecast. So we go by the current level of pricing and the estimates that we were seeing today. And basis that is what we are projecting the kind of number that we have shared.

Sumant Kumar Can we get a geographical mix of revenues for FY2018?

Mayank Singhal You know in the CSM business, we have customers in certain parts of the geography, the material supply is in different part of the geography.

Rajnish Sarna So close to 40% to 42% is domestic revenues and rest is all exports.

Sumant Kumar So in export also can we have bifurcation?

Rajnish Sarna Export is mainly into the three regions, one is Japan, the other is Europe and then the U.S.

Sumant Kumar So how much Japan?

Rajnish Sarna Those numbers would not be there in front of us, we can probably discuss this offhand.

Moderator Thank you. We have the next question from the line of Nitin Gosar from Invesco. Please go ahead.

Nitin Gosar The idea was just to understand the way the accounting goes by, the spillover that you talked about the shipment that has been done and it still was lying at the port, do we account it as sales or do we account it more of inventory for us?

Subhash Anand It gets accounted as inventory because that is not taken as sales.

Rajnish Sarna Yes, not recognized as a sale. This will on inventory.

Nitin Gosar Okay. And in that case, the inventory year-on-year is still flat. So how do I reconcile the shipment which should have got deferred?

Rajnish Sarna Yes, but there are different categories of inventory. So there is for example dip in some inventory, raw material or domestic product, but there is an increase in some other category of inventory. You are absolutely right that overall basis there is no significant change. But obviously, the inventory for exports, those levels went up because of the fag-end dispatches.

Subhash Anand And as a company, we do work on working capital efficiencies and actions were to control inventory had that shipment not got delayed. We would have seen much better working capital this time.

Nitin Gosar Okay. And what could be the quantum if one were to understand ballpark quantum that got deferred because of the delay in shipment?

Rajnish Sarna Yes, it was close to Rs. 70 crore.

Nitin Gosar And your receivable days have gone up, so that is right now close to around Rs. 525 crore versus last year's around Rs. 425 crore, roughly.

Mayank Singhal As you can see in the last quarter, the domestic business witnessed higher growth, so that automatically translates into higher receivables.

Nitin Gosar Okay. But I mean the domestic business has gone up not to that proportion the way we are seeing the jump in the trade receivables.

Mayank Singhal Yes. There is also little delay on the collection front in the season and receivables in the season is also a challenge. So one is on the sales and the other is a little bit of delayed collection.

Nitin Gosar Got it. And would you be in a position to give some kind of guidance on CSM and domestic business expectation for FY2019?

Rajnish Sarna Yes, as we responded to the earlier participants, we are expecting 18%+ kind of growth in FY2019 and frankly, we are expecting similar kind of growth from both the areas domestic revenues as well as exports.

Nitin Gosar Okay. The order book side on CSM any color.

Rajnish Sarna Well, that remained almost the same whatever the incremental orders. I think, there is also shipment taken place in this quarter, so we remained almost at the same level as the last quarter.

Nitin Gosar So last quarter we disclosed it is $1.15 billion.

Rajnish Sarna Yes $1.1 billion around that.

Nitin Gosar Okay. One last clarification, you talked about launching four molecules in CSM side. So now what could be the number of products or molecules that you would have launched in CSM or the molecules which are commercially active?

Rajnish Sarna Well, at present at the commercial scale we are doing close to 24 - 25 molecules and there is also a larger pipeline of products in R&D at different stages.

Nitin Gosar Got it. I am just harping more on this. While doing some kind of analysis on this, can you help us understand, are the 24 molecules having a big difference in the kind of revenue they generate on per molecule basis?

Rajnish Sarna Obviously, there is a difference because these molecules have been commercialized and added at a different point in times and they have their lifecycle. So, yes, I mean, some molecules which were launched maybe three years, four years, five years back they have a different scale and size versus the molecules which have been commercialized say maybe last year or this year.

Nitin Gosar It would be ideal to understand that top five products or top five molecules could be giving more than 60% - 70% of the number?

Mayank Singhal Yes. There is a standard reach of any business that it will be at 70% from 30% molecules.

Moderator Thank you. We have the next question from the line of Chirag Dagli from HDFC Asset Management Company. Please go ahead.

Chirag Dagli This guidance of 18% to 20%, is this in constant currency because your realization in dollars would have been Rs. 64 for FY2018 versus the current at Rs. 67?

Rajnish Sarna Well, currency is quite volatile as you can see. I mean, in last two to three months many things have changed. But, yes, I mean our pricing also takes into account these currency changes in any case. So these will be obviously without considering the currency changes these are the volume changes.

Chirag Dagli Volume basically, okay. Fair point. And the decline in margins whether it is gross or EBITDA whichever level makes you comfortable, this decline that we have seen in FY2018 which business has this more come from? Has it been more India or more exports?

Rajnish Sarna Well, as we explained earlier, in fact, one is that the revenues have remained almost flat, okay. However, in our investments in R&D have continued from a long-term perspective. A lot of new products were also introduced this year. So we have continued in the promotion, again keeping in mind the long-term perspective and these also investment in people and expansion programs and all. So we have continued with our mid-to long-term growth plans. We have not kind of curtailed on our futuristic investments and that is probably reflecting in little stress margins.

Mayank Singhal I would say that the business is long-term outcome based. It has a good gestation period so all the investments that we do now is results in longer-term to mid-term and therefore we have to continue on the mid-to long-term investments.

Chirag Dagli And these investments are for both the businesses – India as well as exports?

Mayank Singhal That is right.

Chirag Dagli Right. And on the Custom Synthesis business gaven that FY2018 has been a flattish year, should not we expect a much more robust growth than the 18% to 20% that you were sort of alluding to? Given that there has been just postponement of some sales, I would have thought that there would be some element of catch up for the flattish FY2018.

Rajnish Sarna From flattish, we are straight heading for 18% to 20% and you will also appreciate that in this business, capacity is the key. So while, frankly speaking, we ourselves are also seeing may be higher growth potential but the key here is to have the capacity in time and this is where we are also kind of putting in a lot of efforts and investment in the current year in terms of debottlenecking in terms of putting up new plants and all. So obviously, we see a robust future outlook in the next couple of years. How much of that will get realized in this financial year, in initial three-four quarters is the question. But in terms of overall robustness of the outlook, yes, it is very much there.

Chirag Dagli Fair point. And last, just clarification, in your opening remarks you mentioned that for FY2019 you will launch four to five products was this for exports or for India?

Rajnish Sarna Yes. So on the domestic side also, we are planning launch four to five new products, new brands and on the export side also while the R&D pipeline is quite huge, but we are expecting to commercialize again four to five products.

Chirag Dagli And these India launches will be all novel products or let us say first in market kind of products or will be also improved genetics?

Rajnish Sarna Well these are a mix of both, so there are few novel products for the first time in India and there are some of these products which we are introducing under co-marketing arrangements with other global companies.

Moderator Thank you. We have the next question from the line of Resham Jain from DSP Blackrock. Please go ahead.

Resham Jain So just two questions. So one is on CAPEX, what kind of CAPEX we have done in FY2018 and going forward FY2019 and FY2020 what are the plans?

Rajnish Sarna So this current year, we have invested close to Rs. 170 crore and we are planning to invest close to Rs. 225 crore to Rs. 250 crore in next two years. Rs. 225 crore to Rs. 250 crore in each of these next years.

Resham Jain So total Rs. 500 crore over two years.

Rajnish Sarna Yes.

Resham Jain And this is primarily in the export led business or domestic also.

Rajnish Sarna Majorly into the export led business but we are also investing in R&D as we explained earlier.

Resham Jain And also if you can explain how does recent rupee depreciation may impact positively or negatively to us in each of the two businesses over the next one year even assuming that there is rupee depreciation of Rs. 68 the current levels may remain.

Rajnish Sarna Well, as far as the export business is concerned, this certainly brings in some positive outcome, although the currency improvement are factored in pricing. But as a country, we become competitive to another alternative to the customer. So for example, if they compare India versus China or versus Europe or Japan then yes, obviously, the Indian partner would be competitive. In terms of domestic, yes, it has an impact on the imports and the cost of the final produce which is depending on the market situation and monsoon and overall scenario, it is generally passed on to the customer.

Resham Jain Just one final question, on these new four molecules which you said you are going to launch this year, any molecule which you feel that is going to become or has a potential to become as large as what you have in the current portfolio. Like, I think out of your five to six current molecules, one of the molecules is slightly larger. Are out of these four new molecules, has any of this molecule has a potential to become large?

Rajnish Sarna Yes, very much. That is the reason they are in the portfolio and we very hopeful of some of these products.

Resham Jain Any color if you want to give on those molecules and whether they are like, which field, which crop any specific treatment they are go into?

Mayank Singhal It is a one broad spectrum insecticide and couple of others are fungicides and herbicides.

Moderator Thank you. We have the next question from the line of Ritesh Gupta from Ambit Capital. Please go ahead.

Ritesh Gupta Just wanted to check, the other income looks fairly higher this time on a full year basis as well as on the quarterly basis. Could you just remind us what are the components of other income apart from the plain vanilla cash income that you get? Are there other components as well in the other income?

Subhash Anand Basically, we have an interest income as we are carrying sizable cash on our balance sheet and that we do earn income on that and that is reflected in other income.

Ritesh Gupta Yes. But I mean, if I look at other operating income as well that has gone up materially so in 2018, your other income is somewhere close to Rs. 60 crore versus EBITDA of Rs. 410 crore, which is like 15%. I mean Rs. 410 crore of EBITDA and Rs. 60 crore of other income, it comes to like 24% of the cash. So, definitely, it is not just interest?

Subhash Anand No, there are some FX gains which we have this year so that is part of other income.

Ritesh Gupta Okay. Is there any export incentive etc. that is also included here, or it is not material?

Subhash Anand That is not I will say material that way. That remained broadly same but not part of other income

Ritesh Gupta Yes, so I even include operating income as well other income in one. So basically, you are saying that it is predominantly interest income and FX income is what you get?

Subhash Anand Yes.

Ritesh Gupta And, on CAPEX side, typically you announce a plant separately, so is there any new plant that you are going to commission in FY2019 - FY2020 or is that just its predominantly the debottlenecking that you are doing in existing plants itself?

Rajnish Sarna Yes, so we are targeting to commission two multi-products plants in the current financial year one by maybe by end of this year that is say December or January 2019 and the other one also around this time. So, we are obviously targeting to commission two plants and MPP-8 & 9.

Ritesh Gupta And this is basically three plants are already there in Jambusar. This is the fourth and fifth plant?

Rajnish Sarna Yes.

Ritesh Gupta And, just on the rupee appreciation bit, just wanted to check that you typically pass on the rupee fluctuation so your pricing is pretty much is in rupees, so there is no benefit of rupee appreciation getting into your P&L, right? It is that correct?

Rajnish Sarna Well, generally, yes, not in all cases this pass on. But generally, yes. But as I mentioned to the earlier participant, the key benefit that we get is that you become more competitive to your customer versus these other strategic partners that they have.

Ritesh Gupta Right. And just one last question on the gross margin side. So you said that this time raw material prices increased, etc. in your previous calls and when I see it on full-year basis your gross margin is only declined 30 bps on Y-o-Y basis and most with the margin drop pretty much comes in from the negative operating leverage that you had probably this year which you also alluded to earlier. So, is that fair to understand that these gross margins are pretty much sustainable and probably can expand a little bit if the China situation or the general inflation in the raw material prices kind of cools off?

Rajnish Sarna Yes, you are right. I mean, we have been able to maintain the product mix and gross margin during this year and the only reason for this on EBITDA is as I explained earlier that we have continued with our investments in these new launches, new products, and R&D and people and other infrastructural issues.

Ritesh Gupta Okay. And the last one, again is, I think you commissioned four molecules in CSM this year and you are looking to commission four-five more molecules next year. So basically, you are talking that at the end of FY2017 you probably had like 20 molecules and then you are going to add eight new molecules over FY2018 and FY2019? Is that correct understanding?

Rajnish Sarna Yes, you are right.

Ritesh Gupta And most of these molecules would be on the patented side or I mean probably will be the kind of innovator molecules?

Rajnish Sarna I mean, these are all proprietary, patented molecules because that is the basic criteria of our getting into new products.

Ritesh Gupta And as all these eight molecules get launched, these all will be commercial launches? These will not be in molecules which are in the R&D pipeline or something like that?

Rajnish Sarna No, absolutely not. So when we talk about commercialization we are talking about commercialization of molecules, we are not talking about the R&D pipeline or scale of the pipeline. Just for clarity, let me explain that this pipeline or R&D pipeline also there is significant increase and improvement in this pipeline during this current year. While the revenues remained flat, as I said earlier also that the inquiry flow significantly increased. And just to give you some perspective on numbers, we used to have maybe some 30 to 35 products in the R&D pipeline but this year we ended up with close to 70 products in that pipeline at different stages of course.

Ritesh Gupta Okay. And most of these again eight and nine molecules are predominantly in agrochemicals side, is that correct understanding?

Rajnish Sarna Most of them, but not all. There are a couple of products which are not in agchem category.

Ritesh Gupta And what would be those categories, if you can disclose?

Rajnish Sarna These are other Fine Chemicals like one is the non-GMP pharma product, the other is electronic chemical products.

Moderator Thank you. We have the next question from the line of Madhav Marda from Fidelity. Please go ahead.

Madhav Marda Just wanted to check your guiding for about 18% growth in the domestic side of the business as well. Given that the market grows much lower than that and even our last three-year performance has been mid-single digits. I mean, guiding for 18% is that more from the new product launches or are we building in a very good monsoon expectation in the forecast?

Rajnish Sarna Both, obviously, yes the key drivers are these new products, but monsoon remains a key factor, if the agro-climatic scenario remains normal.

Mayank Singhal Normal monsoon backed with four introductions last year and with new products, we expect to see certain growth numbers.

Madhav Marda Okay. And also we have significant cash which is building upon the books even with the CAPEX that you are guiding for about Rs. 225 crore, we should have significant cash, I think close to Rs. 500 crore to Rs. 600 cash. So, any plans on deploying that via like a special dividend or we looking at acquisitions in like the pharma space or new sort of acquisition?

Rajnish Sarna Yes, so we have been very actively looking at these opportunities, M&A opportunities during last year as well, we reached to an advanced stage in one of them, but yes because of certain developments and external reasons, we finally decided not to move ahead with that sort of opportunity. But, yes, we are actively looking at these opportunities.

Madhav Marda And any of the newer ones which are in finalization stages or are they all still in preliminary discussion?

Rajnish Sarna Currently, you mean?

Madhav Marda Yes, currently yes.

Rajnish Sarna Yes, they are at a preliminary stage.

Moderator Thank you. We have the next question from the line of Vishnu Kumar from Spark Capital. Please go ahead.

Vishnu Kumar Just wanted to understand on the exports growth which you are talking about, typically second-half is the heavier growth for us. So, is it likely that chunk of the growth is going to come only in the second-half or is it going to be evenly spread?

Rajnish Sarna Well second-half, you mean in FY2019, you are talking?

Vishnu Kumar Yes, in FY2019, the 18% to 20% growth which you are guiding on the CSM part of it, will the growth be more back ended, or we think that it will be more or less balanced this year?

Rajnish Sarna No, it would again, second-half would certainly be higher because we are also as I mentioned earlier that we are also coming up commissioning these new facilities. So, obviously, the second-half we will have more capacity to deliver.

Vishnu Kumar Okay. In general, in the past whenever the capacity gets commissioned you also bump-up or at least we have seen the order book also go up. So this $1.2 billion which you are talking about does it include the potential revenues from the new capacities or can you expect a bump-up probably around whenever you commission this asset?

Rajnish Sarna Well, some of these capacities are part of increasing order book which is already there. So it is just a scale-up of those exiting products you know. And obviously, some of these new products that are now being commercialized and getting scaled up that will certainly add to this order book.

Vishnu Kumar So somewhere during the year, we will see some incremental order book going up during the year that is the question from my side.

Rajnish Sarna Hopefully**,** yes.

Vishnu Kumar Okay. Is it possible to split CAPEX between your R&D investments and for CSM, are we also expanding our R&D even bigger from here or R&D expansion is more or less done?

Mayank Singhal R&D expansion is more or less done, but R&D expenditure is going to continue as we are growing well.

Vishnu Kumar But the CAPEX part is more or less done?

Rajnish Sarna Yes.

Vishnu Kumar Okay. So can you give us some broad idea of the current utilization of your three plants and if I remember right your Phase IV was supposed to be commissioned about a year ago itself but we have kind of postponed it till now. So these two assets, I mean this Rs. 200 crore which you are talking about, the new two plants, is it going to come in the same I mean, the same Jambusar facility or adjacently it is going to build from scratch?

Rajnish Sarna No, the current years facilities are in the existing plot. Yes, but obviously the FY2020 investment would certainly be in the adjacent plot, not the existing plot.

Vishnu Kumar And finally, you did mention that we are obviously looking beyond Agchem and this portfolio is going to help us in terms of our export in a few years. So obviously, this pharma and Fine Chem is what you have been highlighting. Is it likely that we will start doing some business on these verticals say in FY2020 or FY2021?

Rajnish Sarna No, in fact, we are already doing small business in both these areas and not from this year but for last one year or two years, we are already doing. Now the question is scale-up and also getting into many more products and sizeable products and that should hopefully happen in next couple of years.

Vishnu Kumar Your guidance of 18% to 20% if I remove the fourth quarter of Rs. 70 crore which you just highlighted then it just looks like something like a 15% growth. Is it likely that we are a little bit conservative on the growth or this is a realistic number you think we will play out? Because if I strip out the number of Rs. 70 crore which will probably flow through next year it still looks like only a 15% growth on an overall basis?

Rajnish Sarna First of all, I must appreciate your observation and quick calculation. But, yes, having missed this guideline this year, we are really wanting to be bit realistic and safe.

Vishnu Kumar Okay. And finally, you did mention last quarter that you had some raw materials sourcing issues and you are going to backward integrate some of the purchases that you are currently doing. If you could just give some more explanation I mean, clarity on that how much you are investing on that side and just some thoughts on that side.

Rajnish Sarna Yes, on the raw material front, in fact even in the current year we have kind of developed at least six to seven alternative vendors in India for some of these products which we were raw materials which we were earlier importing from China. And that effort and initiative continues even in this year. We are focusing on a time-bound manner developing this Indian manufacturer or Indian suppliers for all these critical raw materials that we are currently importing from China. It takes little time, but we are putting in a very focused effort. Even in China, if suppose we were because of some strategic raw material sourcing reasons is these products are only coming from China and we were procuring these from say one vendor or two vendors in say certain geography, we are making sure that we have alternative suppliers from some other geography. Because these days in China, this is also a big challenge that some industrial estate in a particular geography gets impacted but not the other geography so that aspect also we are taking care in our strategy.

Moderator Thank you. We have the next question from the line of Bharat Shah from ASK. Please go ahead.

Bharat Shah Till 2016 - 2017, PI vehicle was moving at largely third and fourth gear occasionally fifth gear. 2017 - 2018 we moved into reverse gear, I suppose from 2018 - 2019 we will move into probably second and third gear, when do we think we will be hitting again fourth gear?

Mayank Singhal That is a very interesting question. The objective is always to be in the fifth gear, but I think, the external parameters are sometimes challenging. If the industry continues to pick up the trends in the say 2014, 2015 and the 2016 years, we will be back on the gear. So, there are certain current challenges as see on a global basis both from a commodity and demand perspective followed with a little challenge in the confusion in the side of M&A. But I see immense opportunity come our way once these M&As are settled in the next few months as these companies will be more aggressively looking to grow and will also be aggressively looking to outsource to and look at how they could leverage their partners to build out the capacities in order to deliver their numbers.

Bharat Shah So hopefully 2019 - 2020 will be that year?

Mayank Singhal Yes, I would say 2019 - 2020 we will be seeing the gearbox shift, yes.

Bharat Shah Okay. And our long-term view based on the size of the opportunity and our capability and the portfolio of products etc. that long-term growth of 20% to 25% kind of remains?

Rajnish Sarna Yes, that remains, in fact this is precisely the reason that we have continued with our investment in R&D, in people, in infrastructure, in capacities despite facing these short-term headwinds of demand or this external, whether it is Chinese challenge or logistical challenge or revenue challenge. But we have continued and that is the purpose that we have again get back to the kind of demand growth that we have been achieving and the kind of revenue growth.

Mayank Singhal We are not looking to compromise on the long-term investments with the short-term numbers.

Bharat Shah Obviously, I mean, that is always the right thing to do. At the beginning of the call, I heard that R&D expenses doubled in FY2018? How much has been the R&D expenditure in FY2018 compared to FY2017?

Rajnish Sarna About Rs. 55 crore to Rs. 60 crore.

Bharat Shah In FY2018?

Rajnish Sarna Yes.

Bharat Shah And which was like Rs. 30 crore - Rs. 35 crore in FY2017?

Rajnish Sarna Yes.

Bharat Shah And these were charged on the profit and loss account?

Rajnish Sarna Yes.

Bharat Shah Okay. One last thing, what is the likely tax rate for the current year and next year? Tax rate?

Subhash Anand The tax rate in FY2019 will be around 21%. It will continue to be the same rate what we had in FY2018.

Bharat Shah And FY2020 also similar?

Subhash Anand Yes, it will be stable FY2017 was much lower but that was because we had 100% abatement available at that time which has now cut to 50%.

Moderator Thank you. We have the next question from the line of Aditya Jhawar from Investec. Please go ahead.

Aditya Jhawar Just one clarification, you have mentioned that we commercialized four new molecules in the CSM business in FY2018 and our order book still remains about $1.1 billion and I understand that some shipments were shipped during the year. Hence, the order book remains same. Is it fair to assume that these four molecules quantum of dollar value would be not sizable chunk?

Rajnish Sarna Yes. I mean, as it generally works that in the year of commercialization these are very small volumes, these are not significant volumes and then this growth takes place or the scale up takes place in this second year to the third year. So obviously this year their volumes were not significant.

Aditya Jhawar But, generally, this order book I think what I understand is that it is a number four years to five years of the potential of that molecule that we include in that $1 billion?

Rajnish Sarna Yes.

Aditya Jhawar So this four new molecules I understand it would be lower this year, but the quantum would be higher next year and a year after that?

Rajnish Sarna No, no. Let me just clarify that it is not necessary that every new molecule commercialized adds to the order book, not necessary. Because what happens that some of these new molecules which are added or commercialized they are done on an annual PO basis and once you scale up, once you reach to a certain level and once the global innovator also gets a longer-term visibility of this molecule then probably they get into a long-term agreement. For example, today, if we are doing 24 products at a commercial scale, not all these molecules are there for long-term.

Mayank Singhal The order book matters at the early stage, not so much at the mature stage because the early stage is to help us build capacities, efficiencies and planning for the customer, so that is where you really get the order book for an early stage molecule. Once it reaches the four years to five years maturity then it becomes an annualized order because our capacity is running, the customer is doing an annual-to-annual base order.

Aditya Jhawar Okay, fair enough. Sorry, if I am reputing this question. With regard to the issues in China, what is the visibility that our production will not get impacted in the next couple of quarters? Are you seeing that kind of comfort level based on alternate supply sources?

Rajnish Sarna Yes. Certainly, that is part of our planning that best of our ability, we kind of consider not only the obvious options, but also the contingencies that if suppose for certain raw material, if we are procuring from China than what are the alternatives and what are the arrangements at their end. So, yes, I mean, that is all part of our plan and basis our present visibility and understanding, we are expecting this to be a smooth supply season.

Aditya Jhawar Okay. And as a percentage of total raw material, what is the component sourced from China and how would that change over the last few quarters?

Rajnish Sarna Well, it is currently close to, I think 16% - 17% of the total raw materials. I do not know about the last quarter or before that but yes, in last couple of years this percentage has significantly reduced, it used to be more than 30% - 35%.

Mayank Singhal What I would like to tell you is that these are component of chemicals which act together to create a product so depend on which product, which product mix, and what is going on, the percentage may vary. But the point is that we are not largely dependent in China. And gradually we are working to reduce it.

Moderator Thank you. We have the next question from the line of Dheeresh Pathak from Goldman Sachs. Please go ahead.

Dheeresh Pathak Earlier, you mentioned that R&D pipeline also has seen pick-up and there are more molecules in the R&D funnel. So just for my understanding, in this R&D pipeline, does it include molecules which are already commercialized by our innovator partner or these are molecules where they are yet to be commercialized and the innovator is working on regulatory approvals?

Rajnish Sarna No. So this includes both types of products, there are products which are already commercialized but within their patent life. They have been commercialized for the next four years to five years to seven years, the innovator is either manufacturing in-house or they have maybe one source and they wanting to develop another source. So both types of products are also there.

Dheeresh Pathak Okay. And is it possible to just give a sense of our CSM revenues like what percentage would come from products where molecules are commercialized, and we are doing commercialize supplies and what could be coming from where the innovator is still working on regulatory approvals and trials and all those things?

Rajnish Sarna No, so maybe let me try and clarify. When products are commercialized, the innovator has already crossed that stage of regulatory approval and all that, which means that if we have commercialized the product, it is treated as either launched or it is already launched and that just becomes part of their supply chain.

Dheeresh Pathak Right. But we might still be supplying some molecules which the innovator is using for his trial purposes and he has yet not commercialized. So do they make a substantial part of our CSM revenues or they are very small?

Mayank Singhal Clearly, when we work on, that is where the expenses happen so that is a part of expenditure and that is not even marginal revenue. There is no revenue there. Most of the development activities we get into partnerships, so these are spending in that molecule. And for regulatory or for purpose of sending them to foreign countries, we have to bill it at certain price, there is no revenue percentage to that.

Mayank Singhal Yes, that is not significant value.

Dheeresh Pathak Okay. And the second question is for the domestic business, can you give some context in terms of what is our level of vertical integration? Like so for what percentage of our domestic revenues we are like fully vertically integrated and for what percentage of domestic revenues do we buy technicals from outside you know something like that, if you can share something on that side?

Mayank Singhal If you look at our business model, our business model is that of a partnerships, where we are bringing innovative products from global innovators and then we are actually in certain cases formulating or taking a mix unique formulations that are most of the times sitting in the IP space and then we are distributing it under branding. So, we are not like a typical generic company where they are producing and vertically integrated and selling those products but we are more of a value creator from a distribution by bringing unique novel molecules to the countries through partnership.

Dheeresh Pathak So there was some regulatory change that has been talked in terms of import restriction on molecules which are already being made in India. So, there was some confusion in terms of how it could impact companies like us. Can you just explain that if it is of concern of there is nothing on that side?

Mayank Singhal We are more into the IP space where we are looking at patented and new generation molecules which are not manufactured in the country and I do not think the laws has been read in that spirit where it says that they would not allow imports of anything that produced in the country, I think that is not something which is appointing right now.

Moderator Thank you. We have the next question from the line of Ankit Agarwal from Centrum Alternatives. Please go ahead.

Ankit Agarwal If I look at your historical order book and CSM revenues then earlier we used to do almost 30% of our order book as revenues and now if I look at it is almost like 20% of our order book gets converted to revenues. So when I look at future, obviously there were some deferment of revenues from here to FY2019. So should we again go with a 20% sort of an order book conversion? Is that a fair number to go with or can we do something like a $300 million to $350 odd million going ahead also?

Mayank Singhal That would not be a right way of calibrating revenue base and trends as I mentioned some products that grow up and hit maturity then they become annualized orders and the plant hits maturity. In the initial phase, when we trying to set up new molecules is when the order books are building up.

Ankit Agarwal So it is fair to say that they are more late cycle sort of products now in the order book as a result it will get executed over a longer period of time as opposed to what it was earlier?

Rajnish Sarna Yes, see, I think, if I have understood your question basically what you are trying to tell that this percentage which used to be like 30% has reduced to 20%, is not it?

Ankit Agarwal Yes.

Rajnish Sarna There are couple of reasons for that. One, that for some products there is a much longer visibility not only three years to four years, but you would have six years to seven years visibility, okay, this is one reason. The second is that this conversion into revenue is also linked to your capacity and your new built-up. And as I explained earlier, that this year by the end of this year December - January, we are planning to commission two new plants and then there are also plans to add capacities and also debottleneck the existing plant capacities and all. So, what will happen in the year to come, we will certainly increase the scale of revenue from the current level and if we are saying that 18%-20% is the kind of growth rate that we are talking. So, you will again be reaching to that level of 25% to 30% but obviously there will be a lead and lag. When we will reach there, we will also like to build more longer-term visibility in the plan and there will be new products for which again we can go for 7 to 10 years kind of visibility in the plan. So, that lead-to-lag difference will always be there.

Ankit Agarwal But, is it fair to estimate sort of a $300 million run rate maybe in FY20?

Rajnish Sarna Yes, I mean the kind of growth rate that we are indicating, obviously.

Ankit Agarwal And if I look at our earlier Q1 call we are talking about 10% growth in the CSM business and obviously that is not materialized. So, is that getting deferred to FY19 and that also included in the 20% growth guidance or how do we look at it?

Rajnish Sarna So, probably you were not there on the call earlier that we discussed this point that some part of this will also get factored in the next year revenues and growth that we are predicting.

Ankit Agarwal And on the margin front, operating leverage also should play out but are we not expecting that to sort of help us in increasing margins next year?

Rajnish Sarna Yes, we also discussed this question and we explained that since we are continuing our investments in new launches, new products, new commercialization, R&D and other infrastructure developments from longer-term perspective, we are considering that the current margins and the levels will only sustain. We are not expecting them to dramatically improve and change.

Ankit Agarwal And lastly, the growth that we are seeing in the CSM business, is it coming from the growth in the existing molecules, which are going to either more geographies or client is taking more off take of the existing molecules or is this growth coming from new molecule launches also. What part can we sort of break it up between new launches versus growth in existing molecules?

Rajnish Sarna Well it is coming from both, existing as well as new products that we are commercializing. We would not have that breakup in front of us. Maybe we can discuss it off line.

Moderator Thank you. We have the next question from the line of Mohit Pandey from Citigroup. Please go ahead.

Mohit Pandey For the domestic business, the 18% to 20% kind of growth guidance looks very strong. So, you have mentioned that you are expecting contribution from newer molecules and also factoring in favorable monsoons. So, possible to share what kind of contribution you are factoring from the newer molecules?

Mayank Singhal We already communicated earlier, growth rates. Our growth rate percentage is the total percentage.

Mohit Pandey Yes, out of the total 18% to 20% which would mean around Rs. 164 crore of additional revenue as compared to this years. How much should we assume for the newer molecules? 50% i.e. 80 crore–90 crore?

Mayank Singhal Yes, 7%-8%.

Subhash Anand In fact, two things, the products which we launched last year will grow because they are well accepted in the market and they will grow much faster next year and we will gain from that and the new products which we expect will be giving us additional revenue. These two things will be playing important role and delivering our growth in domestic business supported by good monsoon of course.

Mohit Pandey Secondly, on the exports front, based on the current delivery schedules what would be the broad split between first half and second half? Would it be 45-55%? 45% in the first half and 55% in the second half or it would be materially skewed towards the second half.

Rajnish Sarna Yes, it should be around 40-60%.

Mohit Pandey And lastly, I think you mentioned the exact breakup between domestic and exports earlier. Sorry, I missed that could you repeat that please for the fourth quarter and the full year?

Subhash Anand Full year number for FY18, domestic business revenues stood at Rs. 822 crore and export business was Rs. 1,455 crore.

Mohit Pandey And for the fourth quarter if you have that handy?

Subhash Anand The fourth quarter number stood at: Rs. 187 crore domestic and Rs. 438 crore export.

Moderator Thank you. We have the next question from the line of Nitin Agarwal from IDFC. Please go ahead.

Nitin Agarwal Just one question on this, you talked about lot of progress has been made on this CSM pipeline development during the year. Qualitatively, what have been the changes that you have seen in terms of the client interaction which you are having over the last 2-3 years, in terms of the kind of clients, newer clients that you are dealing with the newer kind of chemistries or growth there is coming your way. You can throw some light on that?

Rajnish Sarna Yes, so there are obviously a lot of changes and lot of new developments which are happening. One, in terms of the customer base which is also increasing. So, as against getting more enquiries from existing customers, we are also now getting a lot of enquiries from new customers. So, that is one change that we are seeing.

Then secondly and this is also maybe because of the Chinese situation and also the global M&As that are going on, but lot of very interesting opportunities which were earlier not expected because most of these products were handled by these global innovators in-house are also now coming on table. So, that is an interesting development and lot of interesting technologies which are now getting offered for outsourcing. So, that is another interesting development and in fact in the current year, we have developed at least two technologies which are for the first time in the world. Those technologies were developed, and we have very successfully commercialized.

Mayank Singhal In terms of our capabilities, we are in the forefront of these technological capabilities. Hence, we see a big opportunity for companies like us which are attracting customers to us.

Rajnish Sarna And third of course is that because of this current scenario in China, many of these global innovators are getting nervous and if they had some strategic projects there, they are wanting certainly to develop alternative sources and therefore those kind of projects and enquiries are also flowing.

Nitin Agarwal Is this also sort of leading to increase in maybe average size of the contract that you possibly were getting earlier say a few years back, I mean either it is scale of the business that which you operating in terms of individual contracts. So, it is also sort of changing materially as we go forward?

Rajnish Sarna Well, it is a mix bag I would say, yes there are certain projects where the contracts are quite sizeable but yes there are certain projects where at this stage probably they are not sizeable but as we move on they may turn out to be big opportunities in near future. But there are both kind of products and opportunities.

Nitin Agarwal And, the lastly, in the business that we are doing in CSM right now, what proportion of our revenue comes from projects where we have long-term visibility and what proportion comes from kind of spot supplies if you will that you probably do in a more erratic way in not a very consistent manner.

Rajnish Sarna No, so let me clarify, so first of all in this business nothing is like a spot because in any case you need first of all the process development and its scale up and then you need to have capacity if you are not already having. So, nothing gets materialized without first investing time and effort at least one year, one and half years and in few cases even two years in development. So, there is nothing spot. The only difference is that there are projects where we have may be put investments and in those cases, we would certainly want to first build a very long-term visibility and assurance of the business and in those cases, we certainly insist on long-term contracts.

So, these are one set of products and there are projects and products where these are already there, for example commercialized products there is already one source whether in-house with these innovators or something and there it is more a second source and these products can split in some of these capacitates that we already have. So, these are you can say wide space filler or projects which can fit in your existing time. There again depending on the risk and benefit and all those scenarios, we also decide on doing these businesses on annual basis. That in the beginning of the year or at least maybe 2 year in advance they give us a year or two-year kind of visibility and if we have capacity, we go on and supply these products on annual orders. In which case, we do not have may be 4-5-7 year's contract but there is obviously assurance that since we are the only alternative source, the business will flow on regular basis. So, these are broadly 2 categories. I do not have these numbers that how much of revenue flows from which category but yes, the major business flows from our long-term product category and roughly speaking 30% to 35% is also coming from this other category.

Moderator Thank you. We have the next question from the line of Rahul Veera from Elara Capital. Please go ahead.

Rahul Veera Just wanted some highlights from where you initially started, that there are some internal challenges in the organization that you mentioned. So, can you throw some light on that, other than the logistical issue?

Rajnish Sarna No, not internal challenges of that sort but yes, for example, this year we commercialized four new molecules and as it happens that in its scale up you will always have some teething issues and as I mentioned earlier some of these technologies we have commercialized for the first time in the world. So therefore, I mean we face some time delay issues and all. But that is it nothing of significance.

Rahul Veera And, we earlier had a plan of manufacturing Bispyribac Sodium in India. How is that plan going on?

Mayank Singhal Well, that is progressing well. We have already applied for the registration and we are expecting registration maybe in coming quarter, so as soon as we get that, we will start producing.

Moderator Thank you. We have the next question from the line of Basant Patil from HDFC Securities. Please go ahead.

Basant Patil Just one query. Regarding the molecules, what is the maximum life and duration of the molecule? So, it would be more than, is it fair to understand not more than 6 years-7 years kind of the time duration?

Mayank Singhal No. Just to answer, molecule duration can be as long as 100 years and in our business they are 30 years to 40 years. If we today look at aspirin which we consume for a headache was invented in 1900, which is 118 year molecule in pharma. Agchem there are many molecules which are more than now 50 years-60 years still selling. You have generics or what you call the OP compounds or carbon-mixed compounds.

Rajnish Sarna The largest herbicide is more than 60 years and still selling. So, yes the life span again varies from product to product but normally it is ranging from 20 years to 30 years unless there is some significant resistance for a product.

Basant Patil What is the time duration required to get the commercialize molecule to turn into an order? If we commercialize any molecule now, so in how many months it will be turned into an order book?

Rajnish Sarna No, so let me clarify. I think I explained just to the earlier participant. Not that every commercialization becomes a long-term contract. So, some products for which we are for example investing hugely in building new plants and all. So, obviously we insist that we first get into a long-term contract to securitize our investment and in those cases, we insist on long-term contracts. But then there are products where they are more of white space fillers, it is a good opportunity and if we kind of prove ourselves in terms of optimization of processes, capacities and deliveries. So, we will take up those projects on annual basis and then if there is a future opportunity of higher volumes then we get into some discussions with these innovators that why do not you stop manufacturing in-house or with some other supplier and we invest in long-term capacities. If that kind of scenario emerges then yes, we get into a long-term contract.

Basant Patil And what you indicated the CAPEX amount? So, that includes the registration cost of the molecule is that correct, does that CAPEX includes the registration cost per the molecules?

Rajnish Sarna That is not correct. This is pure capital investment in capacities and in new infrastructure. Registration cost is also not that significant.

Moderator Thank you. Ladies and gentlemen, we will now take the last question from the line of Keyur Pandya from Prabhudas Lilladher. Please go ahead.

Keyur Pandya So, on the raw material front, whether it is indigenous or imported. So, what is the current price strength on the raw material front and how do you see that being passed on especially in the domestic market?

Rajnish Sarna Well, current price trend again varies from product-to-product and raw material to raw material but generally speaking it is uptrend. Prices are increasing, although they are expecting to normalize in may be in a quarter or so. And we have witnessed the sort of situation frankly every year or alternative year. How this will get settled in the domestic market, again lot will depend on the overall scenario, agro-climatic conditions, monsoon how season pans out. So, if that is normal, then it is very normal to pass on the price increase and the competing scenario also matters that in what products, what is the kind of competing scenario that exists.

Keyur Pandya The kind of structural change that is happening in China, should it be considered as a new normal, the higher prices?

Rajnish Sarna Yes, in certain areas yes because if the products are getting substituted by Indian producer at a higher cost that becomes a new normal.

Keyur Pandya Just last one book keeping question, was there any one time consultancy fees in FY18 or something of that sort?

Rajnish Sarna No, such fees.

Moderator Thank you. Ladies and gentlemen, that was the last question. I now hand the conference over to the Management for closing comments. Please go ahead.

Management Thank you, ladies and gentlemen for participating in this conference and your continued interest in PI. We have kind of given you indication of our performance projections for the current year and we shall be putting in our best efforts to meet these projections. Thank you very much.

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