SUDARSHAN

14th February, 2022

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Scrip Code - 506655	**Scrip Symbol - SUDARSCHEM**

Dear Sir,

Sub : Transcript of Analysts / Institutional Investors Conference Call

We are enclosing herewith a transcript of the conference call with analysts / institutional investors, which took place on 25th January, 2022, after announcement of the Unaudited Financial Results (Stand-alone and Consolidated) of the Company for the quarter and nine months ended 31st December, 2021.

The said transcript is also uploaded on the website of the Company.

Kindly take the same on record.

Thanking You,
Yours Faithfully,

For SUDARSHAN CHEMICAL INDUSTRIES LIMITED

MANDAR VELANKAR
DGM – LEGAL & COMPANY SECRETARY

SUDARSHAN CHEMICAL INDUSTRIES LIMITED

SUDARSHAN

"Sudarshan Chemical Industries Limited Q3 FY22 Earnings Conference Call"

January 25, 2022

SUDARSHAN Dolat Capital CHORUS CALL®

MANAGEMENT: **MR. RAJESH RATHI - MANAGING DIRECTOR, SUDARSHAN CHEMICAL INDUSTRIES LIMITED**
MR. NILKANTH NATU - CHIEF FINANCIAL OFFICER, SUDARSHAN CHEMICAL INDUSTRIES LIMITED
MR. VIVEK THAKUR – GM (FINANCE) SUDARSHAN CHEMICAL INDUSTRIES LIMITED
MR. AMEY ATHALYE – DGM (FINANCE) SUDARSHAN CHEMICAL INDUSTRIES LIMITED
MR. MANDAR VELANKAR - COMPANY SECRETARY SUDARSHAN CHEMICAL INDUSTRIES LIMITED

MODERATOR: **MR. ARCHIT JOSHI - DOLAT CAPITAL**

Moderator: Ladies and gentlemen good day and welcome to Sudarshan Chemical Industries Limited Q3 FY22 Earnings Conference Call hosted by Dolat Capital Markets Private Limited.

As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Archit Joshi from Dolat Capital Markets. Thank you and over to you, Mr. Joshi.

Archit Joshi: Good evening one and all. On behalf of Dolat Capital, I welcome you all to the 3Q FY22 Earnings Conference Call of Sudarshan Chemical Industries Limited. I would like to thank the Management for this opportunity to host this call.

From the Management we have with us today, Mr. Rajesh Rathi - Managing Director, Mr. Nilkanth Natu - Chief Financial Officer, Mr. Vivek Thakur - GM (Finance), Amey Athalye - DGM (Finance), and Mr. Mandar Velankar - Company Secretary.

Without further ado I would like to handover the floor to Mr. Rajesh Rathi - Managing Director of Sudarshan Chemical Industries Limited, for his opening remarks, after which we can have the floor open for a Q&A round. Over to you, sir and thank you.

Rajesh Rathi: I am glad to inform you that we view this quarter as a good comeback quarter for us. We could regain some of our revenues. And in this uncertain, difficult time our team has done a great job in regaining some of our margins. Also on the CAPEX area, we progressed well. So, all in all, a very, on a positive note, I said that from here on the journey looks to be great. For more details I am going to request my colleague Mr. Natu, our CFO to take this forward.

Nilkanth Natu: Good evening, ladies and gentlemen, welcome to Sudarshan's Quarter 3 FY22 Earnings Conference Call. Our investor presentation has been uploaded on the stock exchanges for your ready reference.

I would like to take you through the financial highlight for this quarter. On a consolidated basis, total income from operations stood at Rs. 602 crore as compared to Rs. 506 crore for the same period last year. Reporting a growth of 19% year-on-year. This was the highest quarterly sales where we crossed Rs. 600 crore mark for the first time.

EBITDA for the quarter stood at Rs. 74 crore as compared to Rs. 80 crore in Q3 FY21. EBITDA margin stood at 12.3% as compared to 15.7% over the same period, last year. Profit after Tax stood at Rs. 36 crore as compared to Rs. 43 crore for the same period last year. On a nine-month basis, total income from operation is at Rs. 1574 crore versus Rs. 1288 crore in the same period last year, a growth of 22%. EBITDA for the nine months is at Rs. 189 crores versus Rs. 200 crores last year. EBITDA margin is at 12% versus 15.6% over the same period, last year. PAT for the nine month is at Rs. 85 crore versus Rs. 92 crore in the last year.

Now going into the details of our Pigment business, for the quarter income from operations stood at Rs. 560 crores a growth of 17% year-on-year. EBITDA for the quarter is at Rs. 77 crores as compared to Rs. 78 crores in Q3FY21. EBITDA margin stood at 13.7% as compared to 16.3% over the same period last year. However, on a sequential basis, EBITDA margin have improved by 2.5%. Price pass-through, volume growth and overhead cost optimization led to sequential improvement versus Quarter 2, FY22.

Demand momentum in the domestic market continues which we had seen from the middle of Q2. Domestic sales for the quarter stood at Rs. 306 crores as compared to Rs. 251 crore in the same period last year, growth of 17% year-on-year.

Sales in the Coating segment continues to do well, and we saw higher demand coming in the Inks segment which was softer Q2. We did also see improvement in the demands from Plastic segment.

Export for the quarter is at Rs. 254 crore as compared to Rs. 216 crore last year, a growth of 70%. Exports have grown 22% sequentially over Q2 FY22. We gained volume in the international geographies with easing of pressure due to aggressive pricing approach by some of the competitors.

Specialty pigments sales stood at Rs. 375 crore as compared to Rs. 329 crore for the previous year same quarter up by 14% year-on-year. Non-specialty sales for the quarter are at Rs. 185 crore as compared to Rs. 148 crore for the same period, growth of 25% year-on-year.

Gross margin for the quarter stood at 41.6 % as compared to 43.2% for the same period last year. We see input cost pressure continuing in the basic chemicals and the intermediate prices. Our endeavor is to pass majority of the cost increases to the customer. However, we did calibrate pricing decision selectivity to gain volume. Input cost increases normally has a lag effect of a quarter in full pass through to the customer.

Apart from raw material cost increases, we continue to see energy and logistics costs at an elevated level. Coal prices are still above 200% of the levels seen in the last year Quarter 4 FY21. This is pushing up the manufacturing cost. The challenges in the logistics area are continuing and leading to freight cost escalation of three to four times. With the direct as well as indirect material cost pressures lingering, we will have to continue with the selling price increases taking calibrated approach to balance on volume growth.

Now, coming to our CAPEX project, which is our thrust for the future growth. We completed commercialization of CAPEX project worth Rs. 150 crore from ongoing CAPEX plan of Rs. 750 crore in this year December. We expect total capitalization during FY22 will be at

Rs. 300 crore. This will improve CAPEX projects in the new molecules as well as capacity additions in the existing pigments, as well as the infrastructure related CAPEX.

We continue to see gradual ramp up for our yellow pigment products. CAPEX projects to launch new products under high performance pigment and in the inorganic high-performance pigment, our progress well. And we expect commercialization during Q4 FY22.

Our manufacturing plants continue to operate in line with various directives of the government during the last quarter. We remain watchful of actions taken at various state level following third wave of COVID-19. We continue to deploy and practice necessary safety precautions regularly to ensure continuity and uninterrupted functioning of our plants with safety and welfare of our employees being of utmost important.

We look forward to continuing our growth journey and delivering value to our all our stakeholders. With this, we now open the floor for question and answers session. Thank you.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Sanjesh Jain from ICICI Securities. Please go ahead.

Sanjesh Jain: Few questions from my side. First Natuji in your opening statement, you spoke about aggressive pricing in the international market. Can you help us elaborate to understand is it China, which is doing price aggression, we thought that the logistic issue has significantly come down the competitive intensity? But your opening remark actually indicate a very different scenario.

Rajesh Rathi: What Natuji was referring to saying that as we saw a little bit of volume shrinkages in the market because of COVID the market scenario, we saw competitors to be way more aggressive in that quarter. And as the consolidation on some of the M&As were going on, we saw some activities, which were a little more aggressive. I think that's the only context I think what he meant.

Sanjesh Jain: So, we don't see any risk to passing on the inflation is that the line to be read from that statement?

Rajesh Rathi: No, we don’t see the risk in passing on the price. Like as I mentioned that we are passing on this raw material price increase and which has been also evident. So, we will continue to do that.

Sanjesh Jain: The second thing, we spoke about an acceleration in the high-performance pigment starting Q4 from the new product launches and peer acceptance. What are we seeing and where are the areas we are now getting that kind of an increasing result to see that the Q4 could be much, much better?

Rajesh Rathi: Yes, as we said, we are progressing well on the CAPEXs, we are gradually putting all the CAPEXs to put to use, one major molecule, we have been able to put to use now. And we expect we expect the other CAPEXs to get completed either by Q4 and some may spill over to Q1. So that’s where we look at. Also, from progress on some of the products which we had launched previously, we are seeing a good progress and response on them. So, we should see some good ramp-up.

Sanjesh Jain: Couple of questions on the current result, if we see a result, revenue growth looks solid of 27% YoY. How much of it is because of the price increase, which was taken from the RM inflation. And if we were to adjust further what is that adjusted normalized growth we are looking at?

Rajesh Rathi: So, as we also mentioned in the earlier call so we are also looking at the kind of disclosure which we can do as a part of our IR. Currently what we are reporting is the value growth. I think your question is most from also volume.

Sanjesh Jain: So, I am not specifically, because we would have scored high performance product, our specialty mix has gone up. So, I don't think I meant volume. I meant if we were to remove the inflation, which was purely on account of raw material, should the growth be upwards of 20% for us?

Rajesh Rathi: So, I think there has been like you are indicating the mix for us has been better. I mean, we are selling more high-performance pigments, we are selling more effects etc. So, the mix change has been positive and there has been a volume growth too. So, all in all, I think both these effects have had a good result for us. On more specific details, we will look at how to disclose this in more detail, right.

Sanjesh Jain: Just from the new revenue which we have disclosed that the new capacity which we are adding could potentially bring in an additional revenue of Rs. 15 billion. Can you help us understand how much of it will be new product, how much of it is from the existing product, some color on that?

Rajesh Rathi: So, 1500 will be the full potential in the next three years that's what we are saying, right.

Sanjesh Jain: Right, I just wanted to understand out of that 1500, how will the mix be?

Rajesh Rathi: Just back of the envelope calculation. approximately Rs. 600 crores will be new products, rest will be enhancing, or you know not completely blockbuster new products, but enhancing the range, some is volume extension mixes, but blockbuster new products will be about Rs. 600 crores I would say.

Sanjesh Jain: And the remaining will be the normal launches or a facelift or some variation or the modification plus existing product?

Rajesh Rathi: Yes. And also, obviously volume we have gained substantial volumes on some products etc. right.

Sanjesh Jain: So, capacity enhancement.

Rajesh Rathi: Yes.

Sanjesh Jain: What is the margin difference? Or firstly let me understand when we say specialty so, what does that include, when we say specialty in our presentation?

Amey Athalye: So, the specialty pigment consists of Azo Pigment, High Performance Pigment, Cosmetic and the Solvent Dyes.

Sanjesh Jain: Just wanted to understand from the margin perspective, I know we don't disclose margin independently, and I am not looking for the information. I just wanted to understand what is the margin difference between the non-specialty and specialty pigment say if we do say 100% margin in and another 120, what is the ratio of a non-specialty pigment and a specialty-pigment? I am not looking at an absolute margin. Just wanted to see what does the premiumization means from the margin perspective. Ratio will do.

Rajesh Rathi: It varies in broad range between the categories and in certain cases within the category it can vary between product to product also. So, supposing your normal classical non-specialized would-be “x”, then your margins on this can be about 1.5x for the given product in this category.

Sanjesh Jain: Oh, so it's a 50% higher margin business for us.

Rajesh Rathi: No, what I gave was an example and not exact difference. As I mentioned it can vary in broad range and depends on products and categories.

Sanjesh Jain: Yes, so if I say 10% and another you have 15% margin, right, that’s what you are telling.

Rajesh Rathi: Yes, that is with the base of 10% as an example.

Sanjesh Jain: That's quite a meaningful margin accretion if we are able to pull that up.

Moderator: Thank you. The next question is from the line of Ankur Periwal from Axis Capital Limited. Please go ahead.

Ankur Periwal: First question, on the RM inflation and on the gross margin front, your comments in terms of by when do you expect a full pass through, as I understand and as you mentioned that there is some bit of pass through which we have already done in this quarter, but then there was a comment on the overall competitive intensity etc., which would have restricted some bit of this pass through. So, just want to understand from your perspective this 40% odd gross margin that we are looking at currently versus maybe a 43% 44%, when we can see a normalization of these numbers.

Rajesh Rathi: There are two parts --; there are two challenges, I think one challenge is that there has been a continuous increase, so we do an increase then there has been more increase. In fact, Q4 we have seen some more increases which we are passing it on. The second piece here is sir, we are trying to get an absolute, passing on the absolute increases, So, in the absolute increases, sometimes you are not going to see the same percentage changes. So, we are hoping that as soon as the inflationary market kind of starts reducing, we should see percentages going to normal. However, given the current scenario we don't see the current raw material prices moving down, at least for, Q4 definitely. Not sure about Q1 yet, but Q4, we are waiting for China to start and look at all the commodity --

Ankur Periwal: Earlier, you had also mentioned, the cost inflation across the energy cost power, logistics, etc. So, when you are saying you are passing through the inflation, apart from RM are we also renegotiating on these energy costs, etc. or these will be eventually borne by us only?

Rajesh Rathi: We, of course can pass on the energy cost also, but it's a little difficult to pass on the full energy cost increases, because it's an indirect cost so it becomes a little tougher passing on those increases. So, our endeavor is to pass that on, So, I would say some success rate would be not passing on the 100% energy price increases, but somewhere to the tune of around say 70% or something like that.

Ankur Periwal: Another thing on the new product launches, we were expecting large part of the CAPEX to be completed within this quarter, probably some spillover there in Q1. What sort of timeframe would you look at when you see the incremental revenue contribution coming from these new CAPEX, new products? Where I am coming from is there will be some bit of delays or not exactly delays but time lag for product approvals, etc. So, do we see an immediate sort of jump there considering that we would have piloted or seeded the newer products for customer approval already? Or it will take some time and maybe after a few quarters really that benefit should be visible?

Rajesh Rathi: I would say a few quarters because there are two challenges in this; one is as we stabilize this, the raw material costs, which we have bought are on a peak since we have been working in this new product lines. We had to buy these at the peak, whereas some of our competitors would have covered these raw materials much earlier. So, we are looking at a point where we are not at a high. So, that's the reason where we feel that it's, you know, getting the whole benefit, not at the revenue, but as the EBITDA level would take some time.

Ankur Periwal: And we will be largely replacing who here are, the European players or the Chinese players with these new products?

Rajesh Rathi: So, mostly European. It's a mix European, Indian, Chinese, but mainly, only European.

Ankur Periwal: You had earlier mentioned some bit of initiatives on the backward integration as well, which can sort of restrict this RM issues for us in the near future. Any plans for this given that large part of our product lead expansion, the CAPEX plan should largely be behind in the next couple of quarters. So, any thoughts there on the backward integration side?

Rajesh Rathi: On backward integration the Board would finally take a call in March when they approve the budget for next year. From a technology perspective, we are ready, even with the pilot plants we have done several trials. It's a question of as you are aware, due to COVID and several other reasons, these other CAPEXs were delayed. So, that's the reason why we have been holding on to some of these other CAPEXs. But the Board would take a view when we present the final budgets in March to them.

Moderator: Thank you. The next question is from the line of Abhijeet Akella from IIFL Securities. Please go ahead.

Abhijeet Akella: Just a couple of clarifications. One is on the Omicron impact, we have seen some signs of slowdown in India's activity across various sectors, because of the third wave. So, any impact that is visible to you across your key end-use segments for the 4th Quarter of FY22?

Rajesh Rathi: I think India, we were seeing a good pickup last quarter. January we are seeing a slight slowdown, especially in the plastics area we have seen a little bit of a slowdown. But we are hoping that February, March, things will bounce back.

Abhijeet Akella: And the other thing I just wanted to clarify is the CAPEX slide in the presentation, this time talks about Rs. 300 crores of target for FY22. Last quarter, it was about Rs. 400 crores in the presentation. So, just wondering if about Rs. 100 crores is being pushed back to FY23, now?

Rajesh Rathi: So, we expect a few CAPEX to roll into Q1 and that's where we estimate of Rs. 300 crores.

Abhijeet Akella: And one last quick thing, on the tax rate we have been clocking about 25% on the P&L, effective tax rate, is that the rate we should expect to continue going forward?

Nilkanth Natu: Yes, we expect it to continue at or around 25% tax rate. We had shifted to the new tax regime last year so we expect that this rate should continue.

Moderator: Thank you. The next question is from the line of Rohit Nagraj from Emkay Global. Please go ahead.

Rohit Nagraj: First question again, in terms of the pricing environment so, if I am right last quarter, we had indicated that there had been an aggressive pricing by the competition because of the advantage of raw material inventory that the European players had. Now, supposedly that advantage would have been vanished. So, are these European players also increasing the prices and will that make sure that we also take accordingly the prices, price increases in Q4 and going forward.

Rajesh Rathi: So, we are waiting to see how the reaction takes place on some of the pricing etc., but we are hoping that the pricing would increase. But we have been going ahead with some of the price increases. We have been passing on those increases.

Rohit Nagraj: Right but are we seeing price increases by the competitors as well, given the probable environment where the input costs inflation is still high.

Rajesh Rathi: So, we are seeing some increases, yes.

Rohit Nagraj: Second question is we have mentioned capacity utilization at 80%. And last quarter, we had mentioned the same number at 60%. So, is this 80% based on the nine-month CAPEX of Rs. 160 crores or is it excluding the CAPEX for probably last couple of quarters.

Nilkanth Natu: For this particular capacity, what we have reported is excluding this Rs. 160 crores because this particular CAPEX what we have mentioned has been majorly got capitalized in Q3.

Rohit Nagraj: And one just last clarification, I understand that we have engaged few consultants for various initiatives. If you can bifurcate how much is the recurring cost probably from those consultancy fees on a yearly basis or probably one-time costs which are currently embedded and probably will subside going forward.

Rajesh Rathi: I mean, obviously, as you know, we have legal confidentially agreements to talk about this piece, but we see these costs tapering down now.

Moderator: Thank you. My next question is from the line of Dhavan Shah from ICICI Securities. Please go ahead.

Dhavan Shah: So, I have a question related to the volume and realization growth. So, based on the Q2 presentation, I think it was mentioned that 60% utilization and right now it's been moved up to around 80% odd. So, it means that the volume growth should be around 33% odd on quarter-on-quarter, whereas, if I look at the pigment revenue growth, it is around 25%. So, if I look at the Specialty, Non-Specialty revenue mix, it is almost the same on quarter-on-quarter basis. So, was there any price decline, I think it should not be just because of the changes in product mix. So, is that the understanding correct, if you can share thoughts on that? When the pricing decline comes to around 8% odd on quarter-on-quarter basis.

Nilkanth Natu: So, there has not been a price decline. If you are comparing the Q2 and Q3 numbers, there is certain portion wherein, our inventory in the finished goods, we have increased considering the fast-moving SKUs and our demand projection. So, this particular number, what you are looking at is on the production.

Dhavan Shah: But, if I look at the product mix between Specialty, Non-Specialty, I think this Specialty was constituting around 67% in Q2, the same is the contribution Q3 as well, right? So, there should not be on the production mix exchanges variance in the realization and growth or degrowth. So, I am unable to understand the mix because I think if the utilization has been improved, it means that the volume should have grown by around 30% odd on quarter-on-quarter plus, if we look at the gross margin it is dipped by around 180 basis point on quarter-and-quarter. So, because, if I look at the most of the raw material may have been remained stable in the last quarter, because the crude was almost in the range, right. So, I think it should not, I mean, it should not be the cost inflation and we also have passed on some price during this quarter so, I think that should be reflected in the gross margins for Q3, but it is not the case.

Rajesh Rathi: It is a little difficult to understand your question, is it okay to take it offline with you, because we are not able to understand your calculation. So, we could discuss this because it will take up too much of everyone's time --

Moderator: Thank you. The next question is from the line of Kunal from Vallum Capital Advisors. Please go ahead.

Kunal: I wanted to understand firstly, when I look at the slide in your presentation, where you mentioned the progress of the CAPEX and how much revenue you expect for the next three to four years. I observed that we have mentioned this quarter, in the presentation we have mentioned Rs. 1500 crores revenue to be realized from the new CAPEX over three years. And in the previous presentation, when I look at the same slide, it is mentioned around Rs. 1200 crores revenue over three to four years. So, I may be wrong interpreting this, but there is a slight bit of positive, I would say improvement in what you are expecting from this new CAPEX. So, I just wanted to understand, is there any change in the outlook.

Rajesh Rathi: There are two parts to it, in our original projections, when we had shown one year ago, the Rs. 1200 crore included some backward integration, and also some more infrastructure projects. And also, some of the prices had increased and that's why we were giving a fair representation of this. So, two reasons for the Rs. 1500 crores changes, one is the mix of our investment has changed. And some prices have improved.

Kunal: I wanted to understand regarding the project which you commissioned into FY20 and in FY21. So, are the products associated with all those projects now, at least, I mean are all the products in that basket really commercialized, I mean, I am sure, so just I want to understand the status of that. So, is there a certain product --

Rajesh Rathi: Yes, and most of these products, one or two were completely new products, otherwise they were extension of the same line.

Kunal: So, is we say that all the products right now are either they have ramped up to a good extent or they are at least in the process of being ramped up to required capacity, that will be right way to look at it, regarding this --

Rajesh Rathi: Like we said, it would take three years for the full capacity ramp up. So, we are at planned rate.

Kunal: Regarding the projects, which are commissioned this year, in the first three quarters, could you tell me, where those products are, are those products commercially launched or is it still there in the progress and we are going to do it in Q4?

Rajesh Rathi: Unless they are commercially launched, we don't put to use. So, all products, which get commercially launched only then we put the CAPEX use.

Nilkanth Natu: And to answer you on the ramp up, as we already mentioned, in our earlier calls, we expect this to ramp up in three years period to the full capacity.

Kunal: And just one small question. Last year for the same quarter, could you tell me what was the aggregate company level utilization capacity wise. I mean, was it same around 80% or was it different?

Rajesh Rathi: We would have to check, sir.

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

Rajesh Kothari: My first question is with reference to slide #13, if I refer to that slide, 2nd Quarter revenue was 440, 3rd Quarter revenue is 560. So, revenue has increased. At the same time, you mentioned that even 2nd Quarter --. Yes, so your revenue has increased, your capacity utilization therefore is improved that means operating leverage also kicks in. Your product mix there is no change if I look at the below slide, the Specialty versus Non-Specialty there is no change in the product mix. You also mentioned at the end of 2nd Quarter that you are in the process of passing on the higher raw material cost inflation. So, it means there was some price increases as well. But if I look at your gross margins, your gross margins have reduced from 43.5% to 41.6%. And I think everybody is trying to figure it out that what, why it is reduction in gross margins, even in the previous participants questions.

May I request you to please throw some light on, little bit more detail to understand what exactly is happening. Is it that the competitor has basically, pricing environment is so aggressive that you have to take price cut or is it something else can you please explain?

Rajesh Rathi: As I mentioned that we have been focusing on passing on the absolute increases. And when you pass on the absolute increases, the percentage does not get increased to the same level.

Rajesh Kothari: Yes.

Rajesh Rathi: That's the reason.

Rajesh Kothari: So, are you trying to say that when you are doing the change, percentage increase requirement was different whereas what you passed on was lesser than even compared to 2Q because at the end of 2Q presentation, conference call, which happened probably in July, you mentioned that, from here the environment is likely to improve, because you mentioned that you are in the process of taking the price hikes. Higher the price, it means your gross margins probably would improve rather than decline. But your gross margins have declined and that's why there is a --

Rajesh Rathi: So, that's what I am saying. So, supposing you have to pass on Rs. 15, right. So, Rs. 15, so generally in percentage terms, if you have to do Rs. 115, if your base price is Rs. 100, and if you want to pass on Rs. 15, you have to increase more than 15% to maintain your percentage, right. So, we have been focused, the whole industry has been focusing on passing on the absolute increases because passing on the percentage increases would mean that we would have to pass on Rs. 20 to Rs. 22, right. And so that was one reason.

And as I mentioned, we have been seeing increases even after that. Our prediction was that the cost increase will not happen anymore, but we have been seeing increases even after that. But the main reason where you are seeing the percentage is mainly the absolute pass only.

Rajesh Kothari: So, as you move forward you mentioned that Specialty Chemical has 50% higher profitability compared to Non-Specialty. However, if I look at two years trend, three years trend of course, our EBITDA margins have not demonstrated same, it means, probably the Non-Specialty margins have reduced significantly because your Specialty is now already 33% of your, 67% compared to Non-Specialty is only 33%.

So, as you move forward and as your new CAPEX comes on stream, do you see, because the CAPEX takes time to get the peak utilization, as you rightly mentioned, it takes three to four years. Do you see further cost pressure because CAPEX comes on stream, but it takes time for utilization ramp up, so, that is first question.

Second question is, considering that you might be entering into the number of new products, where competitors are already present, to take market share in the initial stages, would you be a little bit more aggressive, maybe for one to two and a half years. And therefore, final impact of this therefore, in EBITA margin, we may not see much improvement that's what you are trying to probably interpret?

Rajesh Rathi: See, I think firstly, let me clarify what I said on the margin difference. What I am saying is, for example, if my margins on the Non-Specialty products is let's say 10% then my margins on the Specialty would be 15% that's the delta, not 50% higher margin. It varies in broad range between the categories and in certain cases within the category it can vary between product to product also. So, secondly, I would not draw long-term conclusions based on a very highly volatile inflationary market. Given the current conditions, these are not normal conditions where everyone in the chemical industry would have seen, where almost all raw materials are at a high, you are dealing with COVID situations, where the demand is fluctuating, you have logistics issues, etc. So, from that perspective, I would not draw any long-term conclusion saying that, how our EBITDA is going to change etc. Our product mix would be gradually changing towards a good mix, a good healthy mix. And we do expect gradual improvement in our process.

Moderator: Thank you. The next participant is Dhruv from HDFC Asset Management. Please go ahead.

Dhruv: This question is probably a bit related to the earlier one. We have seen this margin volatility largely in the gross margin level, a bit understandable given the RM fluctuations that you mentioned, but from a broader structural level, I was just trying to understand the people that you consider as good competitors to you, would they be very different versus in terms of the structure that you have probably in terms of backward integration or something else, that if say for instance, tomorrow the inflation environment remains high, they get to benefit out of this inflation environment versus say for example you.

So, the point is, today what we are seeing is because probably some people have the old stock inventory, low-cost inventory and they are able to price their product better, as you are probably indicating, probably we are not able to do that because probably we have the high-cost inventory. So, but once everything normalizes and stabilize it even at a higher level, do we have a disadvantage versus probably some of the people that you consider as good competitors to you?

Rajesh Rathi: No, I don't –think so.

Dhruv: I mean in terms of the structure that they are probably they are more backward integrated. We are less, I am just trying to understand because historically our margins have been at 15% to 16%, probably about 15% to 17%. So, I am just wondering, once everything normalizes should we be considering something differently.

Nilkanth Natu: So, when we are talking about margins 15% to 17% it is EBTIDA, correct. If we are seeing our EBITDA has been at 16% last year and the year before it was around 15%. So, while we see that, this has been a kind of abnormal period this year, where the raw material volatility and overall cost inflation is high our endeavor is to, one is to protect the volume, second is to improve on the margin to the extent given the price cost increases and passed on.

We explained that once this particular disruption period is normalized and we see the normalization coming back. We expect that we will be coming back to this particular margin range which we had seen in the past few years, and once the scale up of the new CAPEX will start, directionally it should take a couple of basis points ups also. So, this is what we look at.

Dhruv: So, basically just to, so this also means that in terms of the structuring there is not much different. So, there is no reason to think that the margins will be different versus what in a normal scenario they should be.

Nilkanth Natu: As of now, yes, Dhruv, and second point is as Mr. Rathi mentioned about, there was a question on the backward integration, and we mentioned that there are a couple of pilots completed successfully. And we are in the process, once, if we get the approval, and if we get into that backward integration, then it will give us structurally slightly more advantage. But that is in the future.

Dhruv: Got it.

Nilkanth Natu: With the current structure, we see once the normalization is there, directionally we should get the benefit.

Dhruv: And one small question, we are seeing the debt has increased on a YoY basis, but the interest cost remains largely flat, and that to, I mean from a quarter-on-quarter or last year basis, is that because of the capitalization that is happening and hence, and once that also that there should be an increase there.

Nilkanth Natu: So, Dhruv, yes correct observation. So, on the interest cost to two factors, one is for the long-term loans we have been borrowing and till the time we put to use the project, in terms of the capitalization, we capitalize the interest cost. Second part to it is in terms of the working capital loans wherein our treasury has done a great job in terms of getting the better pricing in the market, wherein the pricing which we got is a very aggressive pricing, and we are able to get that benefit. We continue to monitor this.

Dhruv: So, the interest capitalization is remaining only for the remaining CAPEX of, say about Rs. 140 crores, otherwise that Rs. 160 crores is already capitalized.

Nilkanth Natu: Yes, so going forward, it will be for those projects which will get capitalized in future. As we mentioned that part of the capitalization has happened in Q3 incremental cost will come in the next quarter for the projects which we have put to use in this quarter.

Moderator: Thank you. The next question is from the line of Abhijit Sinha from Pi Square Investments. Please go ahead.

Abhijit Sinha: Just want to understand earlier we were looking at about a Rs. 400 crore CAPEX, and now we have reduced that to about Rs. 300 crore. So, what would be the reason, I think you mentioned about COVID, but exactly what was the disruption in the plan?

Rajesh Rathi: As we mentioned we put to use only after the products are fully commercialized. So, a couple of products we expect commercialization slightly to be delayed, which will run into Q1, some of our equipment which we were to also receive for this got slightly delayed.

Abhijit Sinha: So, would that remain Rs. 100 crore CAPEX or like what do we have in mind, for the '23, because I know you just mentioned that it depends on when the entire team, Board decides what the FY23 plan is, but if I look into just the Q1 spillage, what would that be?

Rajesh Rathi: The spillage is about Rs. 100 crore.

Nilkanth Natu: We don't expect this beyond, so whatever we have mentioned as of now, there is a reasonable certainty that we will be able to complete the rest.

Abhijit Sinha: You also mentioned that about Rs. 600 crores out of the Rs. 1500 crores are from the super products that we have made and the rest would be the ones which are already there or some innovation in those segments. So, that Rs. 600 crores, would it be included in the FY20 and FY21 CAPEX that we had already done? Or is it still in the one which is due, like about Rs. 140 crores are due this year, and then another Rs. 100 crore in next quarter.

Nilkanth Natu: Majority would be coming now.

Abhijit Sinha: Also, I understand completely that because of the whole logistics has increased, the costs has increased substantially. So, if it was a normal situation in terms of the logistics, how much money would we have saved comparatively, according to you, because I think, in the last quarter with the plants being shut down, also due to the floods I think that was one of our worst quarters, but this quarter, it's still hurting our profitability --

Rajesh Rathi: I think this quarter our EBITDA has been back almost to normal --

Abhijit Sinha: Correct, it's about 12%, but surely, Q1, we still had a 13%. So, it's still impacted by 100 basis points. It is a great effort to come back.

Rajesh Rathi: Yes. So, from a cost perspective, it's not just the logistic cost, it's the energy cost has gone up substantially as we mentioned. The logistics cost and of course, other than that, the raw material cost. These are the cost factors, which are obviously weighing very heavily specially the energy costs also weighing heavily on the EBITDA.

Abhijit Sinha: Can we quantify that how much we might have like you know, compared to normal scenario, how much we had to pay extra because in terms of the energy, in terms of the logistics, in terms of all these things?

Nilkanth Natu: As we mentioned earlier that in terms of the coal price inflation, we had seen 150% increases in the coal prices as well, as well as in the logistic costs, we have seen two to three times increase.

Moderator: Thank you. The next question is from the line of Yuvan Gupta from Edelweiss Financial Service. Please go ahead.

Yuvan Gupta: A couple of questions, first is on this rising input costs you have mentioned that the logistics challenges continues, and raw material prices are still rising, though you have taken some absolute price increases, but may not be sufficient enough. So, you see that even for the current environment and the current quarter also there is likely to be the margin pressure. And what happens when the raw material prices will start declining. So, you have to once again immediately reduce the pricing to the customers or large part of the benefit you would have been able to retain.

Rajesh Rathi: See generally, there is a, this cycle, like there is a lag in passing on increases. There is a little bit of lag on that, but that's a very short-term again.

Yuvan Gupta: So, you are saying that as soon as the raw material prices will start softening, immediately that benefit also has to be passed on to the customer and even with a faster impact, so the lag even, there will hardly be any lag when the prices are declining.

Rajesh Rathi: So, like we say that there is a quarter, we take a quarter lag in the increases there will be a similar quarter lag.

Yuvan Gupta: Okay, it is the same, but you won't be able to retain the price increase, you have to pass it on.

Rajesh Rathi: Yes, absolutely.

Yuvan Gupta: Out of this Rs. 750 CAPEX, hardly Rs. 100 crore has been spilled over, I mean, probably through the next year and all this CAPEX is almost completed now, where you have mentioned roughly Rs. 1500 crore kind of turnover potential. What is after that, I mean, over next two years, the focus is more on digesting this CAPEX or you have further growth plan and are going to increase. I am going to spend some more money in the CAPEX over the next two to three years. So, what is the next two to three years CAPEX plans?

Rajesh Rathi: Like we were saying by this financial year most of our CAPEX will be completed, there will be some spillover into Q1. I think with this, we have sufficient room for our growth. The only thing like I said, the Board would be closely looking is any backward integration CAPEXs, which we would do, but those will be small in number, that will be a small number.

Yuvan Gupta: So, annual CAPEX for, I mean, over the next two to three years won't be more than probably Rs. 50 crore to Rs. 100 crore, right.

Nilkanth Natu: Yes, as we will have normal maintenance CAPEX.

Rajesh Rathi: He is talking about new CAPEX, this is not talking about the run over, right, I think you are referring to the new --. The Board approves them so, I will not be able to tell you, but it would not be major CAPEXs, I can tell you that.

Yuvan Gupta: So, the cash flow generation will be used for the debt reduction, going forward over the next two to three years.

Nilkanth Natu: Yes, so whatever free cash flow will get generated over the next two to three years, based on the capacity ramp up, due to the new projects, will be used for the debt reduction.

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

Amar: Couple of questions from my side. Firstly, can you just give us some understanding about this new revenue of Rs. 1500 crores, let's say in three years, how the mix would be for the Specialty versus Non-Specialty into this part of the revenue?

Rajesh Rathi: Majority will be specialized.

Amar: So, like current mix of your Specialty is let's say 70-30, will it be same or it would be like 90-20, 90-10 or kind of thing?

Rajesh Rathi: I think we will look at the projection of this, but like I said this, the incremental CAPEX, will be majorly I would say 80% towards specialized.

Amar: And secondly, we have seen round about 150 basis point expansion in the margin, sequential margin improvement in 3rd Quarter and you had broadly done majority of the price hike and many of your year-end client negotiation would be completed in December. So, should we see a similar kind of margin expansion in Q4 as well, something around 150 basis point?

Nilkanth Natu: As we mentioned earlier, while our endeavor is to pass on price increases, there is always some lag. Normally price revision should happen in during Jan/Feb'22. So, what we are expecting that we should be able to maintain/better it, provided there are no further shocks in the raw material. So, we continue to monitor this particular scenario.

Amar: In terms of your RM, if you can give us two to three RMs which is basically haunting you in terms of your margin.

Rajesh Rathi: Right now, every RM is haunting us.

Amar: But broadly like 40%, 50% of your contribution would be?

Rajesh Rathi: Right from caustic soda to nitric acid everything is haunting you in the basic chemicals and packing material also --. So, if you really see this kind of inflation, this raw material has been across all the categories, like we have seen this kind of inflation across it is like length and breadth, very much has covered entire raw material basket. So, right now we are monitoring this, and this has been extraordinary for us to work on.

Moderator: Thank you very much. And I will hand the conference over to Mr. Archit Joshi for closing comments.

Archit Joshi: Thanks a lot, Rajeshji for giving us the opportunity again. And if you have any closing comments to make, please feel free to do so. Thank you. Thanks, once again.

Nilkanth Natu: Thank you, Archit and thank you participants for your time and interest in Sudarshan Chemicals. We remain confident in the long-term prospect of our business. And we look forward to engaging with you again in future. Thank you, stay safe.

Moderator: Thank you very much. On behalf of Dolat Capital Markets Private Limited that concludes this conference. Thank you for joining us, you may now disconnect your lines. Thank you.