Company Name: Oriental Aromatics Ltd

Quarter under review: Q2-FY21

Oriental Aromatics Ltd – Q2-FY21 Concall Highlights:

Financial Highlights:

Oriental Aromatics Ltd								
INR In Mn	**Q2-FY21**	**Q1-FY21**	**Q-o-Q**	**Q2-FY20**	**Y-o-Y**	**H1-FY21**	**H1-FY20**	**Y-o-Y**
Operational Income	1,838	1,133	62.3%	2,042	-10.0%	2,971	4,163	-28.6%
EBITDA	491	183	167.8%	275	78.5%	678	632	7.2%
EBITDA M (%)	26.69%	16.17%	NA	13.46%	NA	22.81%	15.18%	763 bps
PAT	332	99	234.9%	267	24.4%	432	447	-3.4%
PAT M (%)	18.08%	8.77%	931 bps	13.09%	499 bps	14.53%	10.74%	379 bps
Diluted EPS	9.88	2.95	NA	7.94	24.4%	12.83	13.28	-3.4%

Operational Highlights:

- With ease in the lockdown restrictions, the company witnessed a healthy demand for its products.
- Production volumes on a Y-o-Y basis were better for most of the products. This points to all our manufacturing sites reaching pre- Covid productions levels with healthy demand.
- Sales Volumes for the quarter have grown by 49% on a Q-o-Q basis, while they remained flat on a Y-o-Y basis.
- With improvement in the sales realizations along with the stability of raw material prices, the company had a good run this quarter with increased the profit margins. Growth can be seen on a quarter on quarter basis as well as year on year.
- As on 30th September, 2020 cash from operations stood at INR 354 Mn. This is due to the improvement in the working capital cycle and better sales realizations.
- Company reduced its net debt further by INR 333 Mn to INR 175 Mn.
- Cash profit stood at INR 378 Mn, an increase of 20.38% on a Y-o-Y basis and a substantial increase in Q-o-Q basis.
- Debt/Equity ratio as on 30thSeptember 2020 improved to 0.03 from 0.11 as on 31st March 2020.
- The Company received the allotment letter for land which it had applied to the MIDC in Mahad for the upcoming greenfield capex

Key Questions & Answers discussed during the Concall:

- **What is the reason behind improvement in gross margins? Are the new margins sustainable?** There are many factors affecting this. The first one is the raw material prices. The second reason is robust demand in the quarter leading to higher sales realisations. When it comes to sustainability we aim 15-17% EBITDA margins. Going forward the raw material prices are going to see fluctuations and similarly will the sale prices.

- **Has the product mix changed? Are some products contributing to higher margins?** There is no product mix change. The camphor, fragrance and flavour division continues to be very strong which has led to improved profitability.

- **Any update on the Baroda plant capex?** The Baroda expansion continues to be on track, we expect to make INR 60 Cr of investment by March. After our last call we have made some changes in the product mix in the in Baroda, which will require additional INR 60 Cr capital. We expect to complete this by Q3-Q4 of FY22. Taking the total investment to 120-125 Cr.

- **So the capex has gone from INR 60 Cr to INR 120? Cr** Yes, this is largely due to the product mix changes we have made in the specialty chemicals.

- **What will be the asset turnover for this Baroda Capex?** We are expecting 1.7-1.8 times.

- **Can you provide some more details on the Greenfield capex in Mahad?** The investment amount remains the same which is INR 150- 200 Cr, the product mix of this plant is being finalized. We are hopeful that the construction for that plant will start by end of Q3. At that same time we will apply for environmental clearances. Although, the entire Mahad expansion is based on ZLD and we are expecting that the environmental clearance will not be such a big issue.

- **Our inventory's around INR 200 Cr towards the end of the quarter as compared to the previous quarter, is there any specific reason for the same?** We are just being cautious since we are expecting certain areas of the business to see a raw material price increase and hence we have taken some long position.

- **Can you throw some light on how is the fine fragrance and deodorant segment is performing?** There continues to be pressure globally and will continue until air travel resumes to normalcy, duty-frees open and people get back to normal lifestyle. I think the fragrance and deodorant will continue to be in a lot of pressure. Especially in the middle east, the far east, Europe and America also. This one segment continues to stay a concern for the industry.

- **Is the company back at pre-Covid levels?** In terms of volumes we are back a pre-covid levels. I think there has been some panic buying in the last 2 quarters. We are not seeing any big effect going in the third quarter. Except for some few segments like deodorants and fine fragrance we do not see any reduction in demand. With the festive season coming we expect higher sales. We are at a 100% capacity utilisation in terms of sales across all our plants.

- **How much have we invested in Mahad Land? Once we get the environment clearance how much time will it take to start production?** Final amounts we will be able to confirm later on. In the chemical business environmental clearance are simultaneous with the construction. So the first two plants at Mahad, we will be ready with the master plant at the of this year. We are somewhere around 400-450 days from the first plant being commissioned. Some plants will be coming on earlier.

- **Can you elaborate on the demand on camphor and the sustainability?** As I said we will stay with the 15%-17% EBITDA guidance. With the festive season coming the demand will increase for the products. We are at 100% capacity at all our plants.

- **What factors did affect sales in the quarter?** Mainly because of demand and supply for camphor fragrances. There is robust demand for the products.

- **From which industries are we seeing a demand for the product?** I think from air care which includes air fresher and candles. Especially from air-refreshers as most of the people are still sitting at home. The Incense sticks did well because of the festive season. Camphor continues to be robust. It is a very healing product from all aspects, whether its religious or just want to burn it at home. Also international demand for fabric softeners and detergents continue to show positive signs. The soaps and detergents business in the last 2 quarters seems to be average where we supply our fragrances

- **What's the rational behind adding capacity? Do you think there will be additional demand in the market?** So we are a research and development oriented company. We believe in investing our resources in R&D. I think the specialty chemical where we are making most of our investments are not just going to increase our production volume, we are going to see a large geographical shift under the China plus strategy. Global F&F customers are also looking at us, hoping that we can provide solutions for them. It is also a replacement investment where we believe a lot of molecules we are going to produce need another player in the market.

- **How will we compete with China on alpha pinene considering China is a major manufacturer of pine based materials and the Chinese players have a raw material supply advantage?** China is not the only country where pinene based materials are available. There are multiple countries where it is available. Our dependency on Chinese Alpha pinene is in single digits. Moreover, the expansion that we are doing now is not primarily pinene based. There may be some part of this expansion which may require pinene chemistry but that pinene today is available in multiple countries and there is absolutely no dependency on China

- **How does the research and development process work?** We understand the aroma chemicals as we have been using these since 1955. We know which aroma chemicals are used to manufacture which flavours and fragrances. We, internal R&D Capability and market intelligence study hundreds of products a month which are available in the domestic and global market. We know which materials are going to go off-patent and where our capabilities and strengths lie. We will continue to focus on musk, rose, sandals, amber, etc family molecules. We have close to 5,000-6000 molecules in our business. It is up to the individual company to decide that which molecule they wish to enter into the market. We pick and choose our battles based on the available market, the number of players and selecting a mix where there is high value, low volume and a few mid value with a slightly higher volume molecules in the specialty aroma chemical space. There is enough room for a company like OAL to choose which molecule to commercialise. Process starts with the flavour team, which works with the R&D Team, then they decide the molecule of the future and the current molecules in demand. Then the R&D will do its study and present it to management. If you recall we are launching 3 molecules in this year. In 2021, we will launch 15-20 molecule. Our R&D pipeline is very robust and with the expansion plans, we can fulfil the demand.

- **Are there any soft commitments from the customers for additional orders related to capacity expansion?** We are a conservative company. We take calculated risk and don't work on soft commitments. I and my team believe that if we have a product that is well researched and we have it at the right price, we can grab market share. We are confident on our product mix and the path we chosen.

- **What is the total capex for Baroda and Mahad?** For Mahad it is between INR 150-200 Cr, for Baroda it goes upto INR 125 Cr. In total 325 Crs in a period of 1000- 1300 Days. At Baroda, we have made an investment of INR 15-18 Cr for the brownfield capex while the greenfield capex at Baroda, we will invest another INR 110 Cr.

- **How do you see your revenue traction in the coming 2-3 years?** We are looking at 1.7x asset turnover based on the investment we are doing. So with an investment of INR 325 Cr, we can expect revenues of INR 500 Cr approximately over the period of 450 days to the next 1000-1200 days.

- **Of the 3 segments which segment contributes the most in terms of revenue and margins?** It would come from camphor, fragrance and specialty chemicals.

- **What's the reason behind camphor segment growth?** We got on the right side of raw material and selling price.

- **Can you tell me the revenue disruption for camphor, fragrance and specialty chemicals?** It stays the same as last year. 1% up or down since camphor and fragrances have performed better this quarter.

- **Are there an expansion plans in Bareilly as well?** Yes, we do. We are adding some capacities there for some of our terpene chemicals where we feel that there will be a good opportunity for growth in these materials especially during the Covid driven hygiene and sanitation requirement. Other than that, we are also putting up a Boiler system at Barreilly to make the plant more sustainable.

- **What has been the de-growth on a Y-o-Y basis in the deodorant and fine fragrance category?** It should be around 25%. Q1- FY21 non- existence for that segment and the facility was being used to make alcohol based sanitizers.

- **The historic fixed asset turnover ratio has been around 2 times. Is there any reason why we are expecting a lower turnover of 1.7-1.8 times for the future capex?** It is very difficult for us to give you an exact figure. However, since we are conservative in whatever we say, we are giving a 1.7 kind of number though the historical turnover was around 2 times.

- **The management has planned for a INR 300-325 Cr capex for the next 3 years. What portion of this can be expected to be funded through debt?** The company will as much as possible, fund it capex through internal accruals since we have been making healthy cash flows. However, if required, we may raise some debt as well. Moreover, the capex is spread over a period of 1000 days and our balance sheet very well supports this kind of capex.

- **Are we witnessing any surge in inquiries from our Tier one FMCG customers?** Yes, definitely. Q1 was more silent. However, in Q2, the FMCG companies are planning their launches for next year and hence we are seeing good enquiries with R&D in the F&F segment reviving to post Covid levels.

- **Which are the key countries from where we procure our raw materials?** On the pinene front, we look at Vietnam, Brazil, Indonesia, Madagascar, etc. On the petro products, we look at Malaysia, Europe and the Americas. So we have a very diversified split of raw material sourcing.

- **Is there any volume growth possible considering that we are already running at 100% utilization levels as mentioned?** Unless we have additional capacities, we will not see any volume growth. We have a brown flied capex in Baroda where the capacities will be available as early as next month and that would us additional revenues of at least INR 15-18 Cr. The remaining capex at Baroda will be staggered and come in another 300 odd days.

Key Participants:

- Rahul Jain – Credence Wealth
- Rohit Nagraj - Sunidhi Securities
- Rajesh Aynor- ITI Ltd
- Dwanil Desai – Turtle Capital
- Deepak Poddar- Sapphire Capital
- Kunal Mahindra – Vallum Capital
- Aman Vij- Astute Investment Management
- Amar Mourya- Alfacurate Advisors
- Anupam Agarwal – Lucky Investment Managers
- Shweta Jain – ANS Wealth
- Devang Patel – Crest Wealth