



Aarti Drugs Limited

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June 9, 2021

To,
Listing/ Compliance Department
BSE Limited
Phiroze Jeejeebhoy Towers,
Dalal Street,
Mumbai – 400 001
BSE CODE: 524348

To,
Listing/ Compliance Department
**National Stock Exchange of India
Limited,**
“Exchange Plaza”, Plot No. C/1,
G Block Bandra - Kurla Complex,
Bandra (East),
Mumbai – 400051
NSE CODE: AARTIDRUGS

Dear Sir/Madam,

**Sub: Transcript of Q4 FY2021 Earning
Conference Call**

Please find attached herewith transcript of Q4 FY21 Earning Conference Call.

Kindly take the same on record.

Thanking you,

Yours faithfully,

FOR AARTI DRUGS LIMITED

RUSHIKESH DEOLE

COMPANY SECRETARY & COMPLIANCE OFFICER

ICSI M.No.: A54527



“Aarti Drugs Limited
Q4 FY2021 Earnings Conference Call”

May 17, 2021



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MANAGEMENT: **MR. HARSHIT SAVLA - JOINT MANAGING DIRECTOR
– AARTI DRUGS LIMITED**
**MR. HARIT SHAH – WHOLE-TIME DIRECTOR -
AARTI DRUGS LIMITED**
**MR. ADHISH PATIL - CHIEF FINANCIAL OFFICER -
AARTI DRUGS LIMITED**
**MR. VISHWA SAVLA – MANAGING DIRECTOR -
PINNACLE LIFE SCIENCE PRIVATE LIMITED**
MR. CHINMAY MADGULKAR – INVESTOR RELATIONS
MR. JIGAR KAVAIYA – INVESTOR RELATIONS

Moderator: Ladies and gentlemen, good day and welcome to Aarti Drugs Limited Q4 FY2021 earnings call. This conference call may contain forward-looking statements about the company, which are based on the beliefs, opinions, and expectations of the company as on the date of this call. These statements are not the guarantees of future performance and involve risks and uncertainties that are difficult to predict. 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 to Mr. Adhish Patil. Thank you and over to you, Sir!

Adhish Patil: Thank you. Good afternoon everyone and a very warm welcome to all of you present on the call to discuss our financial results for Q4 and FY2021. In the wake of the second wave of COVID-19, we hope all of you and your loved ones are healthy and safe. We hope everyone is following the regulations and safety protocols laid out by various authorities.

We are happy to share that in FY2021, Aarti Drugs has delivered a strong performance. For FY2021, our consolidated revenue stood at Rs.2,159.3 Crores a growth of 19.5% year-on-year basis, revenue mix between domestic and exports revenue stood at 65% is to 35% as compared to 66% is to 34% in FY2020.

API contributed 79%, specialty and intermediates put together contributed around 8% and formulations contributed around 13% of the consolidated revenues. In the March 2021 quarter consolidated revenue stood at Rs.502.7 Crores a growth of 11.6% year-on-year basis. During the March 2021 quarter, API contributed 78%, specialty and intermediates put together contributed around 10% and formulations contributed around 12% of the consolidated revenues.

I will now take you through the standalone business performance. For FY2021, standalone revenues from operations stood at Rs.1,914.9 Crores a growth of 17.1% year-on-year basis. Approximately 10% of this growth in the standalone segment was driven by volume growth due to the good demand across multiple therapies.

Therapy-wise the anti-biotic category contributed around 44%, anti-protozoal around 15%, anti-inflammatory around 12%, anti-diabetic around 10%, anti-fungal around 6% and the rest contributed around 13%. The anti-inflammatory segment's share to the total standalone revenue increased mainly on an account of good sales of products like Nimesulide, Diclofenac Sodium, and its derivatives and Celecoxib. 65% of this revenue came from the domestic market and 35% from the export market. Domestic revenue grew approximately by 15.4% and exports by around 20.6%. As discussed during our past earnings call demand for anti-protozoal and some of the anti-biotic products remain subdued due to lockdowns across the country during the year. We are expecting this demand to normalize once people start travelling regularly.

For the current March 2021 quarter, standalone revenues stood at Rs.452.08 Crores a growth of 11.2% on a year-on-year basis. During the quarter, we witnessed a shutdown of two of our

Tarapur plants in the months of January and February. On the annual basis, the impact was not significant as the shutdown lasted less than a couple of months. To mitigate this kind of risk in future, the company has recently converted two more of its manufacturing locations to the zero-liquid discharge category in addition to two existing zero-liquid discharge facilities since two years. Further, the company is in the process to achieve zero-liquid discharge operations for four more facilities in Tarapur. For your benefit zero-liquid discharge is a treatment process designed for all the organic liquid-based pharmacy. The focus of this process is to segregate the effluent into a various category, extract byproducts like salts and produce clean water that is suitable for reuse in some cases. Thereby being more eco-friendly. Also being a part of socially responsible corporate in the current dark conditions of the pandemic, the company recently donated oxygen plants to the government hospital to help those who were severely affected by COVID-19.

Now we will talk about formulation segment performance. For FY2021, formulation revenue stood at Rs.284.9 Crores a growth of 36.5% year-on-year basis approximately 36% of the formulation revenue came from exports for FY2021. For the March 2021 quarter, revenue for formulation stood at Rs.61.9 Crores a growth of 22.2% year-on-year basis. Profitability was slightly low due to the lack of execution of export orders, which will come in coming quarters. Also the second wave of COVID-19 has little impact on the full utilization of the capacity.

On a consolidated basis for FY2021, gross margins expanded by approximately 400 basis points on a year-on-year basis to 38.9%. With the improvement in our operating leverage process efficiencies and better realization in sales, our EBITDA margins showed a meaningful improvement to 20.5% for FY2021. We will be able to maintain our EBITDA margins in the range of 18% to 20% going forward. Profit after tax before other comprehensive income for FY2021 stood at Rs.280.4 Crores as against Rs.141.4 Crores year-on-year basis. EPS for FY2021 stood at Rs.30.09 compared to Rs.15.14 in FY2020. We are very confident in strengthening our topline performance further in FY2022 based on the incremental capacities, which would be available in near future.

For Q4 FY2021, EBITDA grew 13.3% Y-o-Y to Rs.81.9 Crores. EBITDA margins expanded to 16.3%, profit before tax excluding exceptional items for Q4 FY2021 stood at Rs. 65.3 Crores as against Rs. 52.3 Crores year-on-year basis. Our balance sheet continues to remain robust. Our gross debt stood at Rs. 344 Crores of which Rs. 187 Crores would be the term loan. Our net debt to equity ratio improved to 0.38x from 0.6x in FY2020. However, our leverage is expected to increase slightly to some extent as we continue to ramp up our capacities through Greenfield and Brownfield capex. Nonetheless, a lower cost of debt is expected to augment our return ratios further. Return on equity for FY2021 stood at 35.8% as against 23.7% in FY2020. Significant improvement in ROE was led by better process efficiency, lower interest costs and robust growth in profitability due to better realizations in selling prices.

Our pretax ROCE, return on capital employed stood at 34.2% as against 20.4% in FY2020. The net operating working capital requirement was a little higher on account of the higher RM inventory level. We are taking steps to reduce it and in the coming quarters, we will see the results in terms of working capital requirement. The company incurred a capex of Rs.88 Crores

in FY2021 and we are planning a capex of tentatively Rs. 550 Crores over a period of three years for backward integration and capacity expansion. The majority of this capex will be done over the period of the next two to three years and would be mostly funded through internal accrual. We are expecting an asset turnover of 2x to 2.5x on this investment once the entire capex is completed and utilizations are at full potential.

Credit rating agencies like ICRA and CRISIL both have reaffirmed our debt credit rating long-term facility to AA- with the stable outlook and A1 plus for the short-term facility. The strong credit rating will further allow us to cut down our rate of interest which in turn would reduce our interest outgo thereby improving our ROE further.

In line with our shareholder payout policy, we have announced a share buyback worth Rs.60 Crores and a dividend of Rs.2.5 per share during the last financial year. The Board has approved a share buyback of Rs. 60 Crores in March 2021, which is currently ongoing. Cumulatively, we have distributed approximately Rs. 195 Crores in the form of dividend and share buyback over the last six years, which includes the ongoing share buyback as well.

Our strategy to invest in backward integration has played a pivotal role in our strong performance. While the industry is facing supply chain issues due to constraints of supply coming from China our operations are largely unaffected due to these disruptions on the account of backward integration. We will continue to invest in backward integration to be self-reliant for various input materials and casings going forward. Apart from derisking the backward integration will also help to improve margin profile and return ratios. The company is well on track of increasing the contribution from lifestyle and chronic therapeutic areas and reducing the share of acute therapies in our API business. Our recently expanded anti-inflammatory capacity has already started contributing to the growth.

We have a robust pipeline of products under development for API and finished dosages with more focus on antifungal, antidiabetic, and anticoagulant therapies. The company is also in the process of commissioning a new production line for antidiabetic production. In fact, they have already commercially launched one of the antidiabetic products as of now. In addition, Brownfield expansion of one of the antibiotic products would also be completed shortly. We are committed to exploring more opportunities in the regulated markets with enhanced data integrity and automation.

As far as US FDA is concerned, we have a recent dialogue with the authorities for one of our product for additional data, but however, due to the recent second wave, our plan for a mock audit by an ex-US FDA inspector slightly got delayed.

We can now begin with the Q&A session. We will be open to take questions from you guys.

Moderator:

Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Shanti Patel from Shanti Patel Investment Advisors. Please go ahead.

- Shanti Patel:** Good afternoon, Sir. My question was after completing this capex spread over a period of three years what will be the approximate turnover of the company, it will be 2x or 3x as compared to our turnover operations and our profitability ratio and return on capital employed and return on equity will remain constant or it will increase according to you?
- Adhish Patil:** I got your question. The thing is after the completion of this capex and once we start utilizing this capacity to the full extent, we are confident that we should be able to reach a turnover of anywhere between Rs. 4,500 Crores and Rs. 5,000 Crores per annum on a consolidated basis, and as far as return ratios are concerned definitely FY2021 was very good, but still, we feel that with all these products coming into the picture, our EBITDA ratios should get enhanced and it should move upwards of 20% on a very stable basis.
- Shanti Patel:** No, the return on capital employed, which is on equity will increase then is it correct?
- Adhish Patil:** Yes.
- Shanti Patel:** As far as the strong capacity at present is concerned how much it is utilized 100% or less than 100%?
- Adhish Patil:** With 100% of utilization our standalone will make a sale of around Rs. 2,500 Crores to Rs. 2,600 Crores and formulation another can easily go to Rs. 350 Crores to Rs. 400 Crores so with the current capacity, we do have a potential of anywhere between Rs. 2,800 Crores and Rs. 3,000 Crores.
- Shanti Patel:** Thank you very much.
- Moderator:** Thank you. The next question is from the line of Runjhun Jain from Nirmal Bang. Please go ahead.
- Runjhun Jain:** Thank you for the opportunity. Sir, you said in the opening due to the COVID related issues there would some lower capacity utilization, would you like to elaborate that and I was wondering because Q4 did not have so many cases, which were actually started coming more in from April, so would we have the kind of issue in Q1 also?
- Adhish Patil:** Yes, as far as the API capacities are concerned, in the month of April and till half of May, we did not have any shortages in production due to COVID, but on the formulation side, I would like to ask Vishwa to comment on it.
- Vishwa Savla:** On the operation side, we also in the quarter in the last Q4 we did not have any production-related issues because of COVID, it was, in fact, more of lower demand in the Q4; however, in the current quarter in the April and May we have faced severe manpower issues due to the COVID related issue.

- Runjhun Jain:** So, you are saying that because of the COVID related issues there was lower demand in Q4 which led to the lower profitability?
- Vishwa Savla:** As far as formulations is concerned there was a lower demand, which was due to a higher stocking, the stock levels get higher in the domestic market overall, which rationalized in the Q4 and due to this there was a fall in demand in Q4, which again picked in April. For the APIs, Adhish can comment.
- Runjhun Jain:** So, Q1 is normalized now?
- Vishwa Savla:** Q1 is normalized, yes.
- Runjhun Jain:** Sir, can you also give some outlook about the sales growth over the next year, you are saying that the new facility is coming up, so what kind of growth we can see in the coming year?
- Adhish Patil:** On the API side on the standalone business there are few incremental capacities, which are coming up, nothing too meaningful, as compared to the Greenfield capex, which we were talking about, but still we are targeting a volume growth of around 10% to 15% in the coming years.
- Runjhun Jain:** That is only for API, right?
- Adhish Patil:** Only for API I am talking about, yes.
- Runjhun Jain:** And formulation would be?
- Vishwa Savla:** The formulations in this financial year all the increment would come from our existing capacities only as well as in formulations we do have a substantial business from our contract manufacturing side, so we are estimating revenues in the range of around Rs. 320 Crores to Rs. 340 Crores in the coming financial year and we do have a capex plan of around Rs. 40 Crores to Rs. 45 Crores in the current financial year, which would start kicking in revenues partially from the next year.
- Runjhun Jain:** Sir, this Rs. 40 Crores to Rs. 45 Crores of capex, is it the part of that Rs. 550 Crores capex, which you had given for over three years?
- Adhish Patil:** No, the formulation capex is in addition to that.
- Runjhun Jain:** Sir, just last question, this year we have seen that over the last year profitability has improved quite handsomely and next year you are saying that that is why you have been relatively always given that you are maintaining 18% to 20% of EBITDA margins, so we have got around 20% in FY2021 itself so you are saying that there might be some pressure on profitability in FY2022?
- Adhish Patil:** Yes, we are just being conservative, there were few instances in the late March quarter. Few of the raw material prices going up on an account of some shortages in terms of one of the supply is

going down in a particular product, but then with the streamlining of supplies some of these prices, which have gone up should ease down that is what we are expecting, but just to be on a conservative side we are saying 18% to 20% is fair enough to estimate or expect.

- Runjhun Jain:** Thank you.
- Moderator:** Thank you. The next question is from the line of Laxmi Singh from Athena Health. Please go ahead.
- Laxmi Singh:** Thank you for the opportunity. So, my first question is I wanted to know why the promoters holding has been decreased more than 2% in the last two years? Can you just give some idea about it?
- Adhish Patil:** It has not decreased significantly as such and to some extended families might be selling their shares, but the core promoter families they not selling much, so there is nothing like a decided plan of reducing the holding because may one of the family because of the cash flow requirement might have sold a little bit, but overall there is no such systematic selling in promoters.
- Laxmi Singh:** So, is the debt-to-equity ratio has been changed or has it increased in this quarter?
- Adhish Patil:** Debt to equity ratio?
- Laxmi Singh:** Yes.
- Adhish Patil:** The debt to equity ratio has improved quite a lot. In fact, in the history of the company I think it should be the lowest, it is 0.38x right now.
- Laxmi Singh:** Can you tell the reason for a decrease in sales like in Q4?
- Adhish Patil:** Yes, as Vishwa told on the formulation side little bit of demand aspect was there, but on the API side it was mainly on the account of lower utilization also, so there were few pollutions related in the Tarapur region because of which our capacities did suffer in Q4. The utilization was only 64%, which usually is very high for us, so that was the main reason why the sales were low in Q4, but to reduce that risk in future what we have done is that particular unit, which faced shutdown we have already converted that into zero-liquid discharge operation and we have already got the permission also from NPCB for operating the unit and we applied for three more and we have already started operating zero-discharge units, we have to get the formal letter from them, but as far as operations are concerned the new four units are already converted into the zero-discharge.
- Laxmi Singh:** You mentioned that we are opening a few more facilities also?

- Adhish Patil:** I was saying that a couple of more existing facilities only that also we are converting into zero-discharge in near future may be in a couple of months to quarters and we have just installed few equipments related to that in Tarapur region.
- Laxmi Singh:** Thank you so much.
- Moderator:** Thank you. The next question is from the line of Abdul Puranwala from Anand Rathi. Please go ahead.
- Abdul Puranwala:** Thank you for the opportunity. Sir, my first question is in relation to the geographical risk in FY2021, so which in the presentation North America sales have gone up from 7% to 11%, so would you throw some light on why this increase is there considering that the plant is still not approved?
- Vishwa Savla:** Yes, there are a couple of reasons for it. One is we also sell speciality chemicals and intermediates to US, North America and another thing Mexico is also part of North America Continent so I guess that is why you might be misled.
- Abdul Puranwala:** Sir, just one more question on the product under the formulation could you throw some light on what could be the opportunity on the diabetes and the antifungal products versus product development because if we see as your guidance not much is getting build-up for the next two years so from when do we see contribution from this product coming on stream?
- Adhish Patil:** So, the anti-diabetic products, we have already launched one of the product at commercial scale, but what we have done is our plant is yet to be commissioned because of the high demand, from the marketing we were not able to take a small shutdown required to convert that to commission that facility, so we have taken that in one of our another multipurpose plant as of now, but then this product will give at least something about Rs. 100 Crores of revenue potential might come from this new capacity and we are also expanding our existing products through this debottlenecking, so that is why at least for API and intermediate business around Rs. 2,600 Crores of sales can be reached with whatever capacities which will be available for FY2022.
- Abdul Puranwala:** Sir, my question was specific to the product from the development under different products where there are five product launches on antidiabetic and three on anticoagulant?
- Adhish Patil:** It was more to I think to do with this thing API, I think there might be some mistake, but Vishwa.
- Vishwa Savla:** Yes, we do have antidiabetic and anticoagulant products under development and some are under filing; however, these are for regulated markets and the patent expiry I mean the generic launch for these products is 2023 and onwards, so we would expect commercial sales for these products would begin after mid of 2023.
- Abdul Puranwala:** Thank you.

- Moderator:** Thank you. The next question is from the line of Ranveer Singh from Sunidhi Securities. Please go ahead.
- Ranveer Singh:** Thanks for taking my question. Sir, just you mentioned that Rs. 2,600 Crores revenue for FY2022 is the total revenue you are talking about or from the current capacity is peak revenue you have mentioned?
- Adhish Patil:** That is the peak revenue, which we can achieve with the current capacity.
- Ranveer Singh:** So, like in phase 1 Metformin project is already on and phase 2 was scheduled so in FY2022 any part of phase 2 Metformin capacity would be commercialized?
- Adhish Patil:** Yes, this phase 2 actually is like this, in Metformin when we created the plant back in 2013, we are supposed to have 2 phases, first was 600, second 1,200, so that goes to phases that have already been completed. Now another round of expansion, which we are planning that also we are going to do in two phases, so of that first phase will be done by the end of this financial year most probably.
- Ranveer Singh:** So, phase 1 Metformin capacity is already contributing to revenue, right?
- Adhish Patil:** Correct, so it is around 1,000 to 1,100 tonnes per month of capacity is already there.
- Ranveer Singh:** So, what you said that when in FY2022?
- Adhish Patil:** Yes, so what we are planning to do is we are going to scale up this 1,000 tonnes to 2,000 tonnes per month by the end of this year and then after three years it will be scaled up to 3,000 tonnes per month.
- Ranveer Singh:** Secondly for buyback, what is the rationale for this small buyback because already we have debt in our balance sheet, so how does it help us?
- Adhish Patil:** So, it is a part of our shareholder payout policy, which is anywhere between 20% and 30% of PAT so that is the reason why we announced this buyback.
- Ranveer Singh:** Last one if I can, you have already given EBITDA margin guidance, can you give gross margin guidance also because I believe that your capacity has some higher overhead?
- Adhish Patil:** Gross margins, it is difficult to give right now, but I would say it will be anywhere near about 36% or something like that 36% to 37%.
- Ranveer Singh:** That is it from my side. Thank you.
- Moderator:** Thank you. The next question is from the line of Umang Shah from AMSEC Life PMS. Please go ahead.

- Umang Shah:** Sir, thanks for taking my question. Congrats on the good set of numbers. Sir, the first question was you have some multipurpose plants and some capacity, which is for specific products, so if you talk about the effects and economics for both kinds of plants it will be very helpful? Thank you.
- Adhish Patil:** It is like this, you are correct that we do have multipurpose plants also. I would say around 80% of our revenues must be coming from dedicated plants so in dedicated plants we are in only those products, multipurpose plant what happens is products with similar reaction chemistry can be manufactured in the same plant by taking the changeover, but the problem is whenever we do a changeover under the regulatory aspect almost 5 to 7 days are lost in the cleaning process and everything of the product changeover, so the efficiency of the plant keeps on going down as the number of changes increases, so that is the reason why whenever the product is big enough we always go for dedicated capacity possibly to start off with the product we might start with the multipurpose plant because we might want to test the water as far the marketing is concerned and then ultimately as the product grows we convert that into a dedicated facility.
- Umang Shah:** This I asked because you have some and one of the best asset turnovers in the industry from what I understand and also the assets turnovers over the new capacity, which is coming up which is 2 to 2.5 times with working capital included or is it just on fixed assets.
- Adhish Patil:** It is on fixed asset actually.
- Umang Shah:** With working capital how much we will it be any indication?
- Adhish Patil:** Typically working capital is very roughly around 25% to 26% in our business or 25% to 26% of the sales so we can do that calculation.
- Umang Shah:** Just last question, if I could squeeze in was regulation wise in your export market in last 5 to 10 years have not seen any changes or they getting better, stricter, anything on that would be helpful and do you did on a tender basis or do you have it on distributors?
- Adhish Patil:** For the API business you are asking?
- Umang Shah:** Yes.
- Adhish Patil:** As far as regulatory aspect is concerned it has definitely because more and more strict over last five years is in a lot of cases, photostability studies, then recently NBA impurities, elemental analysis, so a lot of new studies are coming up as far as API manufacturing is concerned. So API manufacturing has become a more and more difficult and very skilled job. The kind of specification pharmacopoeia requires as of now is very, very stringent, if you compare the same with 10 years back, so as far as the regulatory aspect is concerned definitely it has become very strict, it is in a way good for people like us, established players like us because it will reduce new entrants. It becomes that much difficult for a new player to enter into a newer molecule so it is good for us. You asked another question, right?

- Umang Shah:** Yes, I just wanted to know if it is tender based, how much is tender base and what is it for the distributors?
- Adhish Patil:** As far as export business is concerned, it depends on the county, so in a particular country if the customer base is fragmented then it is through a distributor, if the customers are large enough to ship their consignment like in a container load, half container load, then it is always a direct business because those kinds of customers prefer to do a customer base is fragmented if it is through distributors.
- Umang Shah:** Got it, Sir. Thank you so much.
- Moderator:** Thank you. The next question is from the line of Sagar from Edelweiss. Please go ahead.
- Sagar:** So, of the capex that you mentioned Rs. 550 Crores coming up over three years, what is the capex that will come on stream in FY2022?
- Adhish Patil:** As in putting to use is very less because this projects will go on and there will be put to use in FY2023 most probably, but there are few like antidiabetic small expansion is there, then antidiabetic small expansion is there and then we are also expanding a chlorosulfonation product at our Tarapur plant, those three projects mini-projects we can call, they will happen in this financial year itself, in fact, the chlorosulfonation capacity, which I am talking about it is almost to the tune of around 400 tonnes per month.
- Sagar:** Got it and can you quantify what was the loss in sales in Q4 due to the regulatory issues?
- Adhish Patil:** Regarding the pollution issues, if we take our utilization of capacity and compare Q4 actually production with our Q2 productions, anywhere between Rs. 60 Crores to Rs. 80 Crores we must have lost.
- Sagar:** Thanks, Adhish.
- Moderator:** Thank you. The next question is from the line of Nimish Mehta from Research Delta Advisors. Please go ahead.
- Nimish Mehta:** Thanks for the question opportunity. One thing if you can let us know how many intermediates are we manufacturing for our own consumption or in other words how many of the APIs that we manufacture are backed up by our own production of intermediates and the plan that we have in terms of capex is that even the backward integration in fact also towards more captive consumption or it is more towards sales in the open market?
- Adhish Patil:** So, the plan which we have for further expansion is for both captive, many of it is for captive consumption, so it will be a part of backward integration and some of it will be selling outside as well and as far as the previous question was concerned that how much backward integrated rather in how many products we are backward integrated. So these 14 to 15 products which we

manufacture, they are contributing almost to around 88% to 90% of our total sales or total spend around sales and in all these 14 to 15 products we are at least equally or more backward integrated than our competitors, so you say almost this 88% to 90% of the sales is backward integrated.

Nimish Mehta: Sir, I want to understand all the KSM required for the 14 to 15 products are manufactured by us?

Adhish Patil: It is more like this, if you can go n number of tests behind but a logic to do go behind is that first of all you should be more backward integrated than your competitors and your peers. That is the first rule and the second would be the KSMs which you are procuring there should be multiple manufacturers available for that KSM. So that there is enough competition amongst them so that you can get the KSM at a good price, if there is some sort of cartelling or undue profit available in the KSM, then usually we go behind and manufacture that.

Nimish Mehta: So, is it not fair to assume that most of the KSMs are imported from China and you are almost required to manufacture all the KSMs from a competitive angle?

Adhish Patil: It depends. I mean just to give you a few examples like Ofloxacin or Levofloxacin. So these products are absolutely imported from China back in 2013 also almost 80% to 90% of India's consumption used to come from China. When we launched this product, we launched along with the OX acids whatever acids which are required to manufacture this product that capacity will also be launched in India, but definitely if you say the raw materials required for those acids, yes, some of them are coming from China, but then inspite of as of today we are proud to say that almost 80% to 90% of India's consumption is happening through our Indian capacities probably for these 3 API, so it all depends upon the competitive landscape. This is how we decide and there are few intermediates, which we are supplying to China as well, few intermediates so that is also there.

Nimish Mehta: Lastly, is it fair to understand assume that intermediate is the bigger opportunity than API or wherever you can manufacture intermediate even for India only that where we can see an opportunity I mean that is a fair understanding, how will you put it?

Adhish Patil: Definitely, we have seen ample cases in the market where intermediates manufacturers have done really well. What we believe in is that specialty chemicals that line of business we feel are more attractive the reason being it has a lot wider application in terms of end-use, so that is the reason why we are looking into this chlorosulfonation products and we have been already doing those products since last 20 years. Now just that we are going through a better route, a better continuous process so now we will be scaling those products like 10 folds than what current capacities we have, so that is the route which we are following for expansion, so that is beyond pharm as well.

Nimish Mehta: So, the customer will be beyond pharma as well?

- Adhish Patil:** Yes, some of them are pharma and some of them beyond pharma as well dyes and intermediates or pigments, colours.
- Nimish Mehta:** Thank you very much.
- Moderator:** Thank you. The next question is from the line of Kunal from Vallum India Discovery Fund. Please go ahead.
- Kunal:** Thank you very much for the opportunity. Just wanted to have the split of the capex in 3 silos. So how much would it be for Greenfield, Brownfield and backward integration?
- Adhish Patil:** I will answer your question a little differently. The Brownfield expansions or whatever debottlenecking exercise we do for incremental capacity enhancement and process improvements alongwith the maintenance capex, all this put together, we are keeping a very rough budget of Rs. 50 Crores to Rs. 60 Crores per annum and for Greenfield we have already announced that Rs. 550 Crores of capex which is lined up for the next three years. Greenfield CAPEX includes few backintegration projects as well.
- Kunal:** Sir, correct me if I am wrong, Rs. 500 Crores to Rs. 550 Crores is for the Greenfield amount, Greenfield capex and some is the amount for the Brownfield and maintenance. Is that the right understanding?
- Adhish Patil:** Correct, yes, that is what I said.
- Kunal:** Perfect and regarding gross margin do you expect any major pressure on the gross margin because the raw material prices are moving up?
- Adhish Patil:** Mr. Harit Shah would answer this question.
- Harit Shah:** Yes, actually this last March, April onwards some of the basic chemicals have moved up consistently due to shutdowns and closure of one or two major plants in the US and Europe. So we expect these to cool down in the next couple of months so we are feeling that there is a pressure for at least for first, two, three months in this year, but eventually selling price also will go up accordingly because we will pass that whatever increased price to the customer. So in day to day basis in one or two month we will be suffering, but otherwise we will catch up once the price stabilizes.
- Kunal:** Sure, and just wanted to understand regarding the Greenfield projects, which we are setting up and which will be more stream in the next 3 to 4 years, so what is the product basket, which you are targeting there you mentioned that you are targeting speciality chemicals where you already used to manufacture these products and now you are increasing the capacity and the speciality chemical facility should be able to come on stream much quicker because of the regulatory requirements of approval would be bigger, so could you give us understanding other than these

speciality chemicals what else is there, which you are targeting in terms of these new products for the new capex?

Adhish Patil: Broadly this Greenfield you can split into four categories; one is the expansion of our current anti-diabetic product as such the expansion is in a big way and then there is one product, which also goes as an intermediate and API in a few of the applications like for skin treatment and then there are a lot of intermediates, which we will be captively consuming and along with that we will also be manufacturing its allied intermediates, which we will be selling outside. Then there is a huge capacity of chlorosulfonation products, which is coming up that mostly will be selling outside and very minor part of it will be consuming captively.

Kunal: Got it, understood. Thank you.

Moderator: Thank you. The next question is from the line of Arun Kumar from Aeris Investment. Please go ahead.

Arun Kumar: Sir, I just want to ask that what is your forward outlook on the margin side and revenue side because earlier you had stated that due to this pollution in the months of January and February you had problems with the production as opposed to that month's we overcome in this quarter, what are your plans for it?

Adhish Patil: So, definitely because of the higher production the operating leverage should definitely help us in increasing the margins in the coming quarter no doubt about that. It will definitely push the margins on a little higher side for higher utilization.

Arun Kumar: What about on revenue front, how much growth you expect?

Adhish Patil: Revenue front for the entire year, so we are targeting anywhere from 10% to 15% of volume growth for the next year.

Arun Kumar: Sure, that is all. Thank you.

Moderator: Thank you. The next question is from the line of Dipen Sheth from Crystal Investment Advisors. Please go ahead.

Dipen Sheth: Thanks for the opportunity. I have a question which is more of a strategic issue I cannot figure out at your company and perhaps you can provide some clarity on this. From what it seems to be and I must confess I am not very familiar with the business, but it seems to me that you are say close to about 80% of the business is in the manufacture of per drugs from a new perspective 78% to 79% and to the best of my understanding none of these products while some of them might be speciality, but none of these products are patented products, they must be generics or almost all of them would be generics so the ability to maintain margins when you are supplying these to formulation makers whether in India may be two-thirds or so 60% also if your sales are to other formulators in India some of them could be to overseas markets. You know your ability

to maintain 20% odd margin profile on this kind of product mix at a time and so many other players in the generic drug space are same in fact some of them are formulators as well are saying that they are suffering from the effects of continuous price erosion in many of these products, then this is what surprises me and may be there is a strategic insight that you can share. Because I do have a very high opinion of the group's ability to identify niche areas where it can do high margins, sustainable margin work, so I am not questioning that this is not going to happen it is just I cannot understand the problems?

Adhish Patil: There are a lot of other intermediates and second business also in India as well close to product profile what we manufacture. They have been doing rather for the last two, three years EBITDA margins of anywhere in 23% to 25%. So it is quite possible. If you scale up a particular product to a large extent, then your economies of scale kick in and when you are able to do that in a product like API, which is also governed by regulatory aspect so even more entry barriers are there from a regulatory standpoint also for APIs and plus the economies of scale which we achieve. So I think the combination of view and plus the fact that and the reason that we reach these economies of scale is purely because of the good technology, good R&D, good process improvement and backward integration because of these three factors we achieve big capacities and once we achieve big capacities and our regulatory framework is already there, well organized so I think this two skills at combined help us to achieve this kind of margins.

Dipen Sheth: Sir, if you allow me to active that is it fair to assume that you would probably be a cost leader in many of the core high volume products?

Adhish Patil: The ones which we manufacture definitely. The one which we manufacture in our 15 products definitely, yes.

Dipen Sheth: You would be a cost leader by a mile. You would not be a small-time cost leader?

Adhish Patil: The thing is this being the cost leader and process improvement in technology is a very continuous process. I mean one year we improve, second and third year, the competitors catch up somehow then you have to improve further so that rate sentiment.

Dipen Sheth: Thank you.

Moderator: Thank you. The next question is from the line of Mitesh Shah from ICICI Direct. Please go ahead.

Mitesh Shah: Thanks for the opportunity. I just have a couple of question, first of all, is zero discharge is too expensive that we lost around R. 60 to 70 crores of sales and then we have decided to do the zero discharge and if it is not required for us then when we can do this zero discharge for all of our plants?

Adhish Patil: This is a good question. Actually, the thing is the zero discharge is slightly expensive no doubt about that. Initially, the CTPs of Tarapur functioning smoothly and in fact the new one also has

come up, the phase 1 has already started, the phase 2 is yet to commence. So there are two CTPs right now in Tarapur old and new, so the units which were connected to the new CTP they are working, there is no problem, but the one which is connected to the old CTP, which was not performing properly that will face a little bit of decrease in terms of production. So now definitely we have taken a call that in fact two of the Tarapur units is already a zero discharge since last three years, two of them we have already converted, we got all the permission also, another two we are running in zero entity operations, but permission is yet to come but that is okay because we are already running the entity and two more units we are looking forward to do in a couple of months or one quarter's time. So we have already done that capex in the month of February, March and April. We are installing the rings, to evaporate it and convert that into solid byproducts. So from opex point of view, a bit of it you might feel a little bit of pinch early on, but I would say maximum on the yearly basis may be around Rs. 15 Crores to Rs. 20 Crores of opex will go, but then there is also a probability of revenue stream being generated from this, which would offset at least 50% or more per cent of this increased cost so there will be efforts, it occupies space also so space which is otherwise for manufactured finished goods so overall, yes, it is expensive. But then I think that is a need of the hour and the shortages of production caused due to this closures are much more expensive than this operations. No doubt about that.

Mitesh Shah: So, in a couple of months you mean to say that we are having zero discharge for all the plants right?

Adhish Patil: Yes, one of them which is connected to the new CTP we continue to run like that, but then we will be very close to converting that to zero, but we do not see the need to do it because CTPs are operating properly in that case.

Mitesh Shah: Have you seen an increase in the competition recently after FY2021, China has an impact and the other players as well, so any change in the competition intensifies?

Adhish Patil: Mr. Harit would you like to answer this question.

Harit Shah: I do not think so far. The only issue is because due to COVID our product profile there was a demand issue anywhere in February. Otherwise, we do not see any competition problem, even competitor is coming in our product range is not there.

Mitesh Shah: Thanks a lot. That is it from my side.

Moderator: Thank you. The next question is from the line of Abdul Puranwala from Anand Rathi. Please go ahead.

Abdul Puranwala: Thank you for the follow-up. Sir, just one question on the PAP capacity by when would we expect this capacity to come in and what would be the quantum of investment on this?

Adhish Patil: Sorry, Abdul, which capacity you said?

- Abdul Puranwala:** Para aminophenol?
- Adhish Patil:** No, it is not in us, Aarti, we are not doing it.
- Abdul Puranwala:** Thank you.
- Moderator:** Thank you. The next question is from the line of Purvi Shah from Kotak. Please go ahead.
- Purvi Shah:** Good afternoon, Sir. I just have two questions, one is on an update buyback as to how much actually you have focused and the other one was if you could say some updates on the PLI scheme where we see the Rs. 1,000 Crores, so if you can give an update on that as well?
- Adhish Patil:** Actually, I could not hear the question very clearly, but the second one I think you asked regarding the PLI scheme?
- Purvi Shah:** Yes, one was on the PLI scheme and the other one was on the buyback updates?
- Adhish Patil:** Buyback updates, so buyback the thing is the rest is all done. Obviously, it is oversubscribed now. Very soon there will be a shareholder payout now in the coming few days. So the process is almost completed. As far as the PLI scheme is concerned, the government recently announced they came up with one more notification recently. They have mentioned three categories and three groups regarding the product of three groups of companies, so we fall in category 2 and group B. So that way it is not huge it is just I think Rs. 2,200 Crores for our group spread over six years so it is like 10% of the selling price for first 4%, 8% and 6% something like that and the conditions what they have mentioned the capex about Rs. 250 Crores that anyways we were supposed to do so that anyways we are going to do. So satisfying the condition is absolutely not an issue for us but then the details of that scheme are not yet out so we do not know the intricacies of that scheme. So once it is out we will come to know.
- Purvi Shah:** What I wanted to understand is also that whenever this PLI scheme comes in effect as in when you actually start production. So they start reflecting into the number may be two years down the line is what I wanted to understand?
- Adhish Patil:** Okay, yes, correct. I think yes, you are correct.
- Purvi Shah:** So, whatever comes, comes after FY2024 onwards?
- Adhish Patil:** I think FY2023 is the first year for the previous PLI scheme.
- Purvi Shah:** Right.
- Adhish Patil:** For the newer ones they have mentioned FY2023 they might come with rectification, I do not know.

- Purvi Shah:** Sir, just what I am trying to say is that for Aarti Drugs when they will start reflecting into the numbers?
- Adhish Patil:** Possibly 2023 or 2024 onwards, you are correct, this year it would not be there.
- Purvi Shah:** The other thing just wanted to reconfirm on the raw mat front that since we have seen a lot of stocking raw materials and supplies from China where the price increase has been quite significant, but we know that mostly for a quarter or two we are protected, but after that how is the situation panning out is all I want to understand because there are only a few players who are getting affected and the others are not getting affected just wanted to understand what is the myth?
- Adhish Patil:** Mr. Harit you answer this question.
- Harit Shah:** It depends on the product mix also. Depending on the product mix normally now what China has done is if there are two or three producers they just made a cartel and increased the price. If there are more than three producers then it is difficult to cartelise within China and whenever Indian producers start thinking to produce that product they want to make money for the next two years because Indian companies will start making, they will take two years to produce that product, so they typically I said those products like PAP, Para aminophenol or CBA the price has almost doubled than last year. So there are many other products and they want to make very fast money and then once the Indian companies are producing they want to dump, that is the strategy that is what we see now.
- Purvi Shah:** It is basically sabotaging the India plans?
- Harit Shah:** Yes, every producer has a strategy. The China producer now has revised that. A lot of Indian companies have started producing intermediates, chemicals, KSMs.
- Purvi Shah:** Sir, basically I just would like to understand your thoughts on that whatever the PLI scheme that the government has shown us like both PLI 1 and PLI 2, do you really think that ground reality could change over the next couple of years for trying to move from China to India that is we are talking on?
- Harit Shah:** Whether it is PLI or non-PLI, Indian companies who are able to compete Chinese with the technology products and other things, they will continue to do in spite it is PLI or non-PLI .So PLI is only like a small-time subsidy and there are a lot of ifs and buts and there is a lot of value addition is there, 70% local value addition is required and all that so it is very difficult to meet PLI conditions actually speaking.
- Purvi Shah:** Forget PLI also, if you do not have PLI, but irrespective of that also because as a company also we are trying to de-risk ourselves from Chinese players for raw material, how successful can the entire industry be, I mean moving China out of the equation?

- Harit Shah:** It depends on the chemistry. Fermentation, India is not at all there in Fermentation technology and some of the products formulation depending on the chemistries, so China is ruling the world actually speaking. So those chemistry, formulations and all India will take 4 to 5 years more to come, the Indian company to start, government giving permission and all that. So gradually, for the next 10 years for the chemical industry and many multinational companies across the world want an alternative to China. So definitely the Indian companies eventually will come out with more and more visions.
- Purvi Shah:** We all have scope to...
- Adhish Patil:** Yes, sure.
- Purvi Shah:** Thank you so much and all the best.
- Moderator:** Thank you. The next question is from the line of Imran Khan from Ratnatraya Capital. Please go ahead.
- Imran Khan:** Sir, just wanted to understand what is happening in terms of pricing especially on the API side. Let us say compared to Q4 FY2021 compared to Q1, Q2 and Q3 of FY2021. So how is the pricing in the recent quarter?
- Adhish Patil:** Pricing is more or less stable, but raw material prices have gone up due to shutdowns and as discussed earlier there are some basic chemical prices have gone up and some intermediate KSM from China has gone up, so eventually we will also increase our price. So it is just short-term there will be an issue, but otherwise longer term we will be able to pass that cost to the customers.
- Imran Khan:** I understand that there has been cost pressure, but the prices are the same, right I mean there is not much difference in the pricing?
- Adhish Patil:** In many products the prices have gone up like many API prices have gone up recently depending on the cost.
- Imran Khan:** Thank you and that is it from my side.
- Moderator:** Thank you. The next question is from the line of Mitesh Shah from ICICI Direct. Please go ahead.
- Mitesh Shah:** Thanks for taking my question again. I have a couple of question. Actually, the ciprofloxacin antidumping duty have you seen any major benefit on that or we can see in FY2022 only?
- Adhish Patil:** No, we are not into cyclosporine so we cannot add anything.
- Mitesh Shah:** Do you have some anti-dumping duty?

Adhish Patil: No, that is ciprofloxacin.

Mitesh Shah: Ciprofloxacin, yes.

Adhish Patil: Okay, there will less import from China. That will be a definite advantage to Indian companies.

Mitesh Shah: How much we are dependent on China for the raw material procurement?

Adhish Patil: It depends on the product to product. In China also the API manufacturer are different and the normal producers are different. So whatever China is producing, API producer is producing, we are not as backward as we are, we are also on the same line or we are more backward, so we do import from China, but there is no issue on the availability as of now.

Mitesh Shah: Got it. Thanks a lot.

Moderator: Thank you. I would now like to hand the conference over to Mr. Adhish Patil for closing comments.

Adhish Patil: Thank you all for joining us on this call. Please, reach out to our IR consultants Strategic Growth Advisors or us directly, should you have any further queries. Stay safe and now we will close this call. Take care. Thank you very much to all.

Moderator: Thank you. On behalf of Aarti Drugs limited that concludes this conference. Thank you for joining us. You may now disconnect your lines.