



Aarti Drugs Limited

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

BSE CODE – 524348

Dear Sir/Madam,

To,
Listing/ Compliance Department
**National Stock Exchange of India
Limited,**
“Exchange Plaza”, Bandra - Kurla Complex,
Bandra (E), Mumbai – 400051

NSE SYMBOL: AARTIDRUGS

Sub: Transcript of Q1 FY23 Earning Conference Call

Please find attached herewith transcript of Q1 FY23 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
Q1 FY2023 Earnings Conference Call”

July 28, 2022

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Management: 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

Moderator: Ladies and gentlemen, good day and welcome to the Aarti Drugs Limited Q1 FY2023 Earnings Conference 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 over to Mr. Adhish Patil – CFO at Aarti Drugs Limited. Thank you and over to you Sir!

Adhish Patil: Thank you. Good morning everyone and thank you for joining us today to discuss our Financial Results for the Quarter Ended June 30, 2022. The company’s performance Q1 FY2023 was impacted due to the challenging business environment in terms of constant depreciation in the domestic currency leading to provision of notional forex losses, lockdowns in China affecting purchase decisions in uncertain scenario, fear of recession in key geographies driven by ongoing geopolitical conflict, and continuous upward momentum in crude, coal and other raw material input cost.

I will now quickly take you through segment wise performance and then I will delve more into impact of rising input costs, the overall demand scenario and the company strategy to counter the ongoing difficulties. First I will take standalone business performance: Standalone revenues for Q1 FY2023 stood at Rs.551.4 Crores as against Rs.507.4 Crores a growth of 9% year-on-year. Standalone business contributed approximately 86% to the consolidated revenue approximately 64% of the standalone revenues came from the domestic market while the remaining 36% came from the exports market for Q1 FY2023. Domestic revenue grew approximately by 3% while exports grew by around 23% year-on-year. Within the API segment the antibiotic therapeutic category contributed around 46%, antidiabetic around 13%, anti-protozoal around 19%, anti-inflammatory around 10%, anti-fungal around 9%, and the rest contributed around 4% to total API sales. For the quarter revenue from operations for specialty chemicals and intermediates stood at Rs.56.8 Crores which grew 21% on year-on-year basis.

Now we will discuss formulation segment performance: For the quarter revenue for formulation stood at Rs.85 Crores as against Rs.86.5 Crores year-on-year basis. Formulation segment contributed approximately 14% to the consolidated revenue for the quarter. Approximately 50% of the revenue came from exports during the quarter. Exports continue to be the key focus area for formulation segment and so far we are able to achieve the targets.

Now coming to the consolidated results: As mentioned earlier the company reported a revenue growth of 7% which was mainly driven by higher realizations in antibiotics, anti-diabetics, anti-protozoals, and specialty chemicals. Demand in API business witnessed lower than anticipated traction as the offtake by the customers remained lower on the account of inventory recalibration at the customers' level due to high API prices. Margin and profitability continued to remain affected as sustained inflationary pressure impacted raw material cost, crude, power and coal cost coupled with sharp depreciation in the currency. This impact is likely to extend to some part of Q2 FY2023 as well. Just to give you some perspective. There is an impact of approximately 4 Crores due to forex movements and Rs.8 Crores due to only rate increase in power and coal cost. The company has undertaken multiple price hikes since the beginning of FY2023 and as a result the company witnessed the highest ever realizations for most of its products in Q1 FY2023 when compared to previous four quarters. Domestic demand for the antibiotic therapeutic category was slightly weaker for Q1 FY2023. In the wake of series of sharp price hikes across almost all our products the demand was subdued for the quarter for the same reason. The company expects normalized margin levels, once the input price volatility stabilizes which is expected from second half of FY2023 onwards. We are already witnessing softening in some of the raw materials and some other input costs although they are still much higher than long-term averages. Debt-to-equity ratio has marginally reduced to 0.51 by the end of Q1 FY2023 in spite of carrying heavier inventories. Thus there is scope to further improve on net operating working capital.

Now coming to the company's ongoing capex: The Company incurred a capex of Rs.35 Crores during the quarter and planning to invest around 250 to 350 Crores for the entire FY2023. The civil construction activity for Gujarat capacity remains well on track; however, heavy monsoons have slowed down the pace temporarily. Tarapur Specialty Chemicals Brownfield capacity for which we had taken scale-up batches in the last quarter has now been ramped up and the optimization process is ongoing at the plant level. The company expects a meaningful contribution from this facility from second half of FY2023 onwards. For Tarapur Greenfield API facility boiler and zero liquid discharge treatment plants have been operationalized from May 2022 and commissioning of the main plant is expected by the end of FY2023. We firmly believe that most of the headwinds are transient in nature rather than structural and hopefully it will improve soon. Our company remains confident of overcoming the challenges and remains optimistic on the opportunities for all the segments in the upcoming years driven by the ongoing project capex, Brownfield expansions and higher utilization of existing capacities. With this we can now begin the question and answer session.

Moderator:

Thank you. We will now begin the question and answer session. The first question is from the line of Rupesh Tatia from IntelSense Capital. Please go ahead.

- Rupesh Tatia:** My first question is in specialty chemicals what is the capex amount we have spent and what is the revenue potential?
- Adhish Patil:** Approximately you can say half of the budget what we have planned in that 500 Crores capex plan will be going for specialty and typically overall, on an overall basis the asset turn is somewhere around 2 to 2.5.
- Rupesh Tatia:** So these 250 Crores you are saying for specialty chemical this is already spent or this is a medium-term plan?
- Adhish Patil:** No, that is ongoing capex which is happening in terms of Greenfield project so it will take around a year to finish approximately.
- Rupesh Tatia:** Yes, but currently we are doing some sampling matches right in specialty chemical?
- Adhish Patil:** Yes, that is the Brownfield expansion that we have carried out in the Tarapur facility.
- Rupesh Tatia:** How much is the amount for that one?
- Adhish Patil:** That is a Brownfield, we do not give out the capex number but then it is much lower, but very roughly around 90 to 100 Crores revenue potential is what we expect from that facility at a full scale level.
- Rupesh Tatia:** Specialty chemical has a better gross margin, EBITDA margin is that a fair understanding?
- Adhish Patil:** Yes, that is true.
- Rupesh Tatia:** Then my second question is I was going through your annual report you have done 39000 metric ton production and our capacity is 49000 metric ton roughly in FY2022 what can we expect by FY2023 both these numbers production and capacity?
- Adhish Patil:** Production numbers definitely some Brownfield expansions will add up sooner and if our target date for the Greenfield expansion of Tarapur facility completes this number will be much higher. Right now since because we have not disclosed the product name and the capacity for the Greenfield project that is why we cannot answer it right now, but then it is an import substitute product and the capacity will be quite huge by the end of FY2023.
- Rupesh Tatia:** So it will be at least for 80000 above from currently roughly 49000, 50000 would it be at least 80000 and above?
- Adhish Patil:** I think, yes, it will be more than 8000, two, three projects comes into commercial production.

- Rupesh Tatia:** Sir, my question is I was going through annual report the R&D spend number was 7 Crores for a revenue base of 2500 Crores roughly the R&D spend number of 7 Crores looks really low when we look at other API companies the R&D spend is in the range of 3% to 4% roughly so is there some accounting difference, we are accounting it differently, the other companies are accounting it differently that is my question?
- Adhish Patil:** Probably to some extent that can be the case because what happens is sometimes we have to take trial batches at a plant scale also, so which is a part of R&D, but then we expense it out and we do not label it as R&D so probably that is why it is looking low and mainly our R&D is into process development and process improvement of the existing products so that is why I think the number looks low.
- Rupesh Tatia:** My final question is in Metformin we were I think roughly around 1100 tons per month capacity what is the current capacity as of Q1 exit can you just give me the number?
- Adhish Patil:** As of now we have reached 1200 tons per month that can be achieved.
- Rupesh Tatia:** This is supposed to go to 2000 tons per month by the end.
- Adhish Patil:** It might take around 12 to 18 months time to achieve that number probably.
- Rupesh Tatia:** What is the capacity utilization right now of Metformin?
- Adhish Patil:** Yes, the last year roughly you can say is two thirds somewhere in mid 60s or something like that.
- Rupesh Tatia:** Okay, thank you. I will come back in the queue.
- Moderator:** Thank you. Next question is from the line of Aejas Lakhani from Unifi Capital. Please go ahead.
- Aejas Lakhani:** Thanks for taking my question. In the press release you mentioned that we have had the highest ever realizations for several API products in Q1 FY2023, but despite the fact the EBITDA margin has been the lowest over the last three years so does that mean the cost pressures were far higher than the realization and could you comment, so, some of it you have already mentioned that some cost pressures are easing out, but what about the realizations, would realization sustain at current level?
- Adhish Patil:** Yes, so the thing is the reason for taking all these price hikes was because the input cost had escalated quite sharply in the beginning of this calendar year for multiple reasons which are highlighted and then we started taking price hikes, but there is always a lag in taking price

hikes because of which definitely the gross margins were squeezed in last quarter, but what we could see the pending orders are even higher than what realizations we achieved in June quarter so probably that will help in the beginning of this Q2 and now a little bit easing in some areas not everywhere in some areas hopefully the situation should improve quickly and the thing is this time for EBITDA margins there had been pressure on two side one was gross contribution margin and other was even at the manufacturing overhead side because of this coal and there was a lot of rate variance and increase in the manufacturing cost which also needs to be taken care ideally by further enhancement in the gross contributions.

Aejas Lakhani: Is it fair to assume this is sort of a bottom that we have hit and from now on EBITDA margins can only improve?

Adhish Patil: Yes, we definitely feel so.

Aejas Lakhani: In terms of volumes would you take a call of reducing some prices so that your volumes are back on track or you would want to have the current prices and then work with new partners to increase the volumes?

Adhish Patil: Yes, so it was very challenging, so to maintain the margin and to pass on the increased input cost we had to take very sharp price hikes and when that thing happens so quickly definitely there is a hit on demand because if at the customer side if the inventories are not at critically low levels they will refrain from making a purchase decision so that impact definitely we have seen majorly in the domestic market. So hopefully right now we do not want to make any variable losses, but as far as we are not making any variable losses for incremental production I think we should go for it means more than margins we should try to focus on the absolute EBITDA numbers in shorter-term like this.

Aejas Lakhani: Got it. I wanted to ask you that you mentioned the inventory recalibration and the demand which was subdued so can you speak a little bit about customer and inventory levels today is that normalized and should we start to see volume upticks in second quarter or there is still inventory left at their end?

Adhish Patil: I think our Director, Mr. Harit Shah would be better able to answer this question.

Harit Shah: In many of the products we see demand picking up again, but still it is not at the like pre-COVID levels like about two years back and what has happened also is that during COVID period growth rate was very high and all companies have budgeted high growth rate for this quarter also so the inventory was very high at the beginning of the year because last quarter they produce more of finished formulations and that is what and all the stocks levels at distributor and super stockist level were very high, but we expect now this quarter we started seeing some improvement from July.

- Aejas Lakhani:** Got it and for all the increase in cost is the present price hike adequate to maintain our levels of gross margins or is the price hike still needed?
- Harit Shah:** Now the raw material prices started softening basically all basic chemical prices went up like for caustic flakes, sulfuric, all sulfur based chemistry due to crude oil, solvent prices they have started correcting now due to overall degrowth in textiles, in pharma last quarter so we feel this quarter there should be definitely improvements in the gross margin.
- Aejas Lakhani:** What is the debt today because we are expecting to say take some incremental debt in the current year for the 250 to 350 Crores of capex right?
- Adhish Patil:** Yes, so as of today the total debt figure on a consolidated basis is around 541 Crores out of which around 187 Crores is long term and rest is the short-term for working capital.
- Aejas Lakhani:** This number is likely to go up by about say 150 Crores during the course of the year is that understanding correct?
- Adhish Patil:** Yes probably it should but then with the increase, so what we were expecting at the peak debt-to-equity can go around 0.7 or something 0.7, 0.75, and 0.78 and then again from there it should start coming down with each quarter because of the additional profit.
- Aejas Lakhani:** Could you quantify that in as a number of the debt instead of the 0.7 is the number at peak 700?
- Adhish Patil:** Yes, right now debt number you mean?
- Aejas Lakhani:** Yes.
- Adhish Patil:** Debt number it is very rough calculation around 50% of this thing will be funded through term debt and at the same side there will be some repayments also around 30 Crores per annum 30 to 40 Crores per annum every year so you can say around 150 something like that.
- Aejas Lakhani:** Yes, 130 Crores incremental from here so 545 Crores is what we are at so we should peak out at 700 and then start to taper down, right okay, got it Sir. Thanks Sir.
- Moderator:** Thank you. Next question is from the line of Bobby Jayaraman from Falcon. Please go ahead.
- Bobby Jayaraman:** What is concerning about your business model is that you do not have any control over your EBITDA margin, the kind of reasons you are giving on INR depreciation and input cost

inflation and all that, that is going to happen in some form or the other all the time, that is out of your control, but it seems that when you raise prices, (inaudible words at 23:41) so given this how are you planning for so much capital expenditure when you do not know what your level of profits is going to be because you do not have control over your margin?

Adhish Patil:

So the thing is one thing is for sure because we have been doing this business since last 30 years what we have realized is that the kind of product profile we have and the kind of efficiencies we have our competitors and the level of backward integration 15% to 16% EBITDA margin is fairly easy means it is not something very optimistic. So definitely this scenario is transitory in nature and it would not sustain for long. So we know that it will revert back, but with this if we stop doing capex that will definitely impact our growth in third and fourth year and as far as this INR depreciation I was talking about because it has happened suddenly in one quarter we had to provide notional forex losses for our open imports, but against that our export orders which we have already taken for two-and-a-half to three months they will be going at a much higher price in the June quarter. So part of that will be offsetted in the September quarter and another thing what had happened is that the power had gone up, power rates had gone up in the month of April and you get all those numbers and bills and everything by mid May or May end. So there was some level of rate variation in the power cost more than approximately around 1.5 Crores and then there was almost 6.5 Crores variation in the rate of coal. So what happens is that many of the times when you negotiate contracts in shorter term it is always done based on what are the input costs, the main key intermediates and accordingly what should be the selling prices but then slowly when this kind of coal prices becomes a new norm then definitely those gross contributions needs to be revised in the newer negotiation. So that also will come back on track apart from that we foresee that approximately around 2 Crores means 2, 2.5 Crores means around 0.5% of the EBITDA margin we can recover by reduction in some cost. Since last quarter we had some exceptional one-time maintenance as well as US FDA remediation cost which also we have booked in last quarter so that will also be not there from the next quarter. So what we feel is that 15% to 16% EBITDA margin we should recover it is just a matter of time means once the volatility stops in macro factors then it should be back on track.

Bobby Jayaraman:

What about the competition from China is it back to pre-COVID?

Adhish Patil:

The stiffest competition from China was in the decade of 2001 to 2010 after that from 2011 to 2020 what we had seen that we had become very competitive against China means I am talking even before pre-COVID levels and then towards the end of 2020 decade the Chinese government had started implementing very strictly all the pollution norms and everything, so their opex has also gone up. Sometimes there might be few cases where a particular raw material or a commodity is available cheaper in China so they might get a benefit of that in few products what we have seen but apart from that from the efficiency point of view and

the overall cost point of view and the process and the technology point of view we are very much competent with China and it is in top 14 products what we manufacture in that in around four or five products we are even larger than Chinese capacity.

Bobby Jayaraman: Right but in terms of pricing because if you go back to the earlier era right 2001 to 2010 your margins were only at 10%.

Adhish Patil: Correct and then we improved in the next.

Bobby Jayaraman: Started getting 15%, 16% after 2013 so given that there has been this major reset after COVID which gives you the conviction that things would not go back to the old days I know the pollution and all that I take that point

Adhish Patil: Even if it goes back to the old days that is what we feel it will be around 15% to 16% pre-COVID means in the COVID actually the margins had gone up even beyond 20%.

Bobby Jayaraman: Right and the reason is because you think the Chinese have higher costs and they would not get into a pricing competition is that the reason?

Adhish Patil: Yes, recently that has been the trend.

Bobby Jayaraman: You make a statement in your press release that when you increase the API prices there was some demand disruption so what are these dealers waiting for lower API prices because at some point they do have to stock up right these are medicines and it is not discretionary?

Adhish Patil: Yes very true and that is the reason why we were at least able to achieve some bit of sale at a very high prices so for the players where they had a little bit higher inventories they must have refrained, but the players where the inventory was critically low they had to make that purchase at the higher price.

Bobby Jayaraman: So if input prices do not come down assuming they are at the same level which is a very probable scenario your margins will only be around this 11%, 12% level is that right?

Adhish Patil: No, if it gets stabilized at this level then slowly if they remain high for a year like this it should again move upwards, it should start going up because ultimately all the businesses they look at return in longer term so if a particular company is not able to make decent enough returns in this business especially API manufacturing is a technology oriented business then people start exiting the competitor start exiting that is what we have seen in the past.

- Bobby Jayaraman:** You are saying if input stabilized in the higher level the formulation guys would have no alternative but it is purchased at higher price?
- Adhish Patil:** Yes and what will happen as of today there are certain pricing caps on the finished formulations at the retail level so even those will be revised by the government if such cost pressures persist for a long time.
- Bobby Jayaraman:** Okay alright so if the margins are in the 15%, 16% then your ROIC do not make sense is that correct the capex that you are undergoing the 600 Crores it is not going to be commercially viable if you do not get that level of margin correct?
- Adhish Patil:** No, what we do internally we check whether the IRRs of the project is beyond 18% or not for the new products what we are launching and if they are then we do and whatever products we have selected as of now they make a lot of sense as of now. Only thing is see when we launch a particular product initially say for depending upon product-to-product three to six months goes in optimizing the process whatever results we have achieved at the lab or the pilot level it takes some time to achieve the similar kind of results at the very big commercial batch level. So that much time goes but then ultimately we are very confident to achieve good return on investments for the newer product.
- Bobby Jayaraman:** Okay thank you very much.
- Moderator:** Thank you. Next question is from the line of Anchal Kansal from Green Portfolio Private Limited. Please go ahead.
- Anchal Kansal:** Good morning Sir. In previous concall you said that you have backed out from PLI scheme as you were able to complete the project in 20 Crores not meeting the government's capex requirement of 80 Crores but in recent investor presentation PLI scheme is still mentioned so I wanted to know if these both are linked?
- Adhish Patil:** The thing is I think that is missed out overlooked we will correct that. Thank you for pointing out.
- Anchal Kansal:** No worries Sir. As we know we have heard a lot about anti-China in some industries impact is already on ground how is it impacting the chemical sector and I wanted to know how dependent are the China on raw materials for FY2023?
- Adhish Patil:** Right now still approximately our imports and indigenous purchases like 50:50 and as I said that around 15% to 18% of the raw materials are available only in China rest can be procured from rest of the world so that risk is always there so we have developed technologies, but right now we are not going ahead with the capex of that particular

backward integration. The newer projects what we are launching few import substitutes also what we are launching for that for raw material of those we would not be dependent on China. So overall on an aggregate basis our dependency should come down ideally.

Anchal Kansal: Can you tell me the capacity utilization on an average give or take and your revenue has decreased 11% quarter-on-quarter how about volume in the same period?

Adhish Patil: Yes so our volume has also decreased. In exports the volume has grown but in domestic market the volume has gone down and the main reason was very high prices which we were trying to fetch in the antibiotic category there we saw a lot of volume degrowth for the first quarter because of the very high prices escalations.

Anchal Kansal: Are we underutilizing the capacity?

Adhish Patil: Yes we are expecting lot to go up.

Anchal Kansal: So the volumes are not rising and we have spare capacity so what is the point of doing capital expenditures?

Adhish Patil: The spare capacities what we have are for particular products and typically 80% to 90% of our revenue comes from dedicated plant and it is just present in nature means for one quarter it is not that the overall market of that product has gone down or will go down, it should come back that volume should come back and plus there is a lot of scope in further increase of market share as well, so that scope is also there.

Anchal Kansal: One more question, EBITDA and PAT margins can be seen declining due to high other expenses so can you please shed some light on the other expenses that you have incurred does this include one-time maintenance and US FDA remediation cost that you just mentioned?

Adhish Patil: Yes, so other expenses will means that will also include all our manufacturing expenses I think the format which we are looking at. That includes manufacturing right there is no separate manufacturing expense in that. We are looking at what we published in the SEBI right.

Anchal Kansal: Yes what we published in the report yesterday.

Adhish Patil: Yes so that includes all the manufacturing expenses one of the most important variation what we have seen is in coal around 6.5 Crores and around 1.5 Crores in power that is only because of the rate variations year-on-year means even if we keep the consumption same just because the increase in the rates of coal and increasing the rates of power means KWH

unit that much cost have gone up and some other would be means increments in the employee means EB expenses and then selling and distribution freight has gone up because of the increase in the crude since February and there are few expenses onetime expenses as well related to the US FDA remediation and a few other expenses which were in one time in some very old plants we had done some maintenance which we expensed out.

Anchal Kansal: Okay thanks a lot Sir.

Moderator: Thank you. Next question is from the line of Chirag Dagli from DSP Mutual Fund. Please go ahead.

Chirag Dagli: Yes thank you for the opportunity. Sir what is the volume growth in Q1?

Adhish Patil: So there is no volume growth in Q1 only the exports has some very small around 2% to 3% kind of a volume growth but mainly all the growth is because of the higher selling rates what we have charged in Q1 and basically it was like either you achieve the volume growth and keep the rates low. So those are the only two options.

Chirag Dagli: Understood so volumes were flat for the quarter?

Adhish Patil: But we expect it to grow because it cannot remain flat for longer periods because then the inventories will go down.

Chirag Dagli: Sure I understand. What percentage of your revenue are long-term contracts versus spot business or is it mostly spot?

Adhish Patil: I will give you a brief summary and then I will ask Harit bhai to answer that question, but in domestic market what happens you can say very roughly I am saying 70% to 80% would be more of a short-term within one month or one, one-and-a-half months delivery, but in exports deliveries are around means the pending orders are around 2.7 to 3 months typically and also a few of the customers they like to do longer-term contracts as well in terms of supply of quantity that ranges anywhere between 6 to 12 months that also is there it is mainly observed in the case of bigger MNCs they like to do longer-term contracts.

Chirag Dagli: But 80% of the domestic business which is two thirds of the business is one month kind of delivery so mostly is what kind of market?

Adhish Patil: For domestic.

Chirag Dagli: Understood. Other thing was on this specialty chemical capex you indicated 250 odd Crores roughly you are likely to have 600 odd Crores kind of sales from this business question is

how do you sell this, who are the customers are these the same customers that you have for pharma, what is the customer set, how are you doing market seating, etc.?

Harit Shah: Yes, actually most of the customers would be chemical companies or intermediate companies or these pharmaceutical companies and we are already selling some products to them so marketing would not be, they would not be a new customer, but some products there will be a new customer specifically for specialty chemical products, but normally we are in touch with them, our other group company also are selling some products to them. So it is a question of your new customer would not be are there, more or less same customers would be there.

Chirag Dagli: You do not see a challenge basically in market?

Harit Shah: No we do not see any challenge here. In one product which we are planning to do is import substitute product so mostly they are imported from China so we will be replacing that with indigenous products.

Chirag Dagli: Understood and in terms of new product launches that you have done in the last two, three years on the API side how has traction been there, are we suboptimal there if you can just give some color of what part of our business today comes from new products launched in the last two, three years and what is the kind of traction that we are expecting?

Adhish Patil: So mainly the new product launches were more on the spec chem side where we have seen more traction in last couple of years. The APIs which we have launched recently that is yet to receive traction since right now I would say it is you can say almost breakeven or that kind of a thing because scale up batches are going on. So right now we have not received any profit from those products you can safely assume that.

Chirag Dagli: So how many are these what is the potential there?

Adhish Patil: The market is big it can go over to 500 Crores overall market potential for this product, but then obviously we have not put those high capacities yet we have only put the capacities for around say 80 to 100 Crores kind of a turnover and once we get traction in that and so after that we will be in fact going for maybe newer plant with much higher capacity once we get success with that level.

Chirag Dagli: So that 80 to 100 Crores potential has also not been reached?

Adhish Patil: No, so we are far from that, so we are still in the process of optimizing the intermediates and doing more backward integration, getting some tolling done for some intermediates so that we can reduce the cost and then we will go full fledged on those products.

- Chirag Dagli:** Understood and how many APIs are these?
- Adhish Patil:** So mainly newer means in Gliptins we have two, in spec chem again one or two products but obviously there are derivatives of chlorosulfonation chemistry only. Also in chlorosulfonation a lot of our earlier products which we used to have, since we had a long list of chlorosulfonation products, but many of them were like though they are there but meaningfully it was not there. So we are hoping to increase the market of that so it will be like as good as a new product in terms of increase in the scale up so there also we are focusing more.
- Chirag Dagli:** No, but that is on the specialty chemicals is that right Sir?
- Adhish Patil:** Correct.
- Chirag Dagli:** No I am saying on the API side there are two gliptins that you talked about what is it?
- Adhish Patil:** Correct and there are a few antifungal products since we have done piloting of that but as of now we are not contributing anything on the bottom-line.
- Chirag Dagli:** Understood, okay Sir, thank you so much.
- Moderator:** Thank you. Next question is from the line of Gagan Talreja from ASK Investment Managers. Please go ahead.
- Gagan Talreja:** Good morning. Sir, my first question is on the tax rate, why is the tax rate for the quarter higher compared to Q1 of last year year-on-year and I think even sequentially?
- Adhish Patil:** I think that is more to do with the deferred tax otherwise it remains same because we have gone for that 22 point something plus taxation so we have opted for that.
- Gagan Talreja:** Full year what should be the tax rate for you then?
- Adhish Patil:** Ideally around 25% is what we expect.
- Gagan Talreja:** What has been the reason for the formulation sales not growing in this quarter they have actually dropped 2% year-on-year?
- Adhish Patil:** Though the formulation sales did not grow but then the profitability was very, very good I think Vishwa is on the call so he will answer this question.
- Vishwa Savla:** Yes, so basically last quarter or last year same quarter sales were higher because of more of domestic tender execution especially some of the COVID related products were also in

higher sales at that time however it has been our constant focus to shift from the domestic to more value-added sales and due to that although there is not a growth in revenues but there is a substantial growth in profitability.

Gagan Talreja: Okay but how should we then think of formulation sales from a full year perspective for FY2023 and going ahead both in terms of growth and in terms of margins?

Vishwa Savla: In current financial year our focus is to grow more in profitability and grow export sales, so our sales expectations for the remaining quarters are more or less in line with our current quarter sales, but at the same time we have a capex project going on which is in the final stages and due to be completed in the next one quarter and which will start adding revenues from the next financial year so that the new block will start to add up capacities for us and start contributing revenues from next financial year.

Gagan Talreja: How much capacity will that effectively add for you?

Vishwa Savla: Basically it is a new line right now we are into general oral solids this is a dedicated facility for oncology so in terms of the number of units it will be lower since it is more of a high value product but our ultimate expectation once it starts in the next in about one-and-a-half to two years is to reach revenues of about 200 to 250 Crores from the new facility.

Gagan Talreja: So 200 to 250 Crores additional sales from the new onco line?

Vishwa Savla: Yes, at the full potential we can reach.

Gagan Talreja: It will take two to two-and-a-half years for you to do that?

Vishwa Savla: Correct.

Gagan Talreja: When you say your margins have improved in formulations if you could give us some idea of how much they have improved year-on-year for you?

Vishwa Savla: Yes, so in this quarter we have achieved a profit before tax of about 12 Crores and in terms of margins it is about 14%, 15%.

Adhish Patil: EBITDA margins year-on-year has grown from 6.7% to now 15% EBITDA in this particular quarter and the PBT margins have also gone up from around 5.8% to around 14%. So it is mainly on the accounts of higher export sales as we showcased that we are focusing more on profitability now and the export sales than the earlier we used to do a lot of toll manufacturing sales which has much lower profitability.

- Gagan Talreja:** Okay so you have discontinued with toll manufacturing and you actually emphasize more on export sales so if you could give us some idea of the sales mix this quarter how much was exports as a proportion of total formulation sales versus last year and also for toll manufacturing how much was it as a proportion of formulation sales compared to last year?
- Vishwa Savla:** We have not discontinued the contract manufacturing our toll manufacturing sales is that we are slowly trying to reduce that in favor of higher capacity utilization for exports. So current quarter would be roughly about 50% of our revenues would be from exports and also there are slightly higher about 5%, 7% more in indirect exports as well.
- Gagan Talreja:** With the onco line would margins have potential to grow further still because of it being maybe a higher realization product versus the plain vanilla whites?
- Vishwa Savla:** Yes, we would expect it to have higher margins and since that would be more concentrated on regulated markets however as currently the scenario in regulated markets is also there is a lot of margin pressure so while we would expect it to be better, but there is also significant competition in oncology in those markets.
- Gagan Talreja:** The next question is around the capacity expansion that you are planning what is the fixed cost associated with the new facilities Greenfield and Brownfield that will come up and what will be the breakeven utilizations for you in these capexes?
- Vishwa Savla:** See, you are asking about the formulation facility right?
- Gagan Talreja:** Not formulation, I am looking at your capital investment plans in aggregate the Tarapur facility and the Gujarat facility as and when they come on stream what is the additional fixed cost and at what utilization do you breakeven?
- Adhish Patil:** Yes, typically the addition of fixed cost once the facility is into use then it will start coming into our financials. More or less whatever we have right now in terms of percentages more or less it would not be impacted much frankly speaking with the addition of fixed cost it will be more or less in line in terms of percentage to sales so that impact would not be that high.
- Gagan Talreja:** What would be the breakeven point in terms of utilization for these capacities?
- Adhish Patil:** Probably we feel that within one year's time we should be able to breakeven means the utilization will go up.
- Gagan Talreja:** So you are saying at one year's time post commissioning you can see these capacities sort of contributing to profit?

Adhish Patil: That is right.

Gagan Talreja: You mentioned that the stringency of the Chinese government regulations on environment standards has increased I would then infer that a certain amount of input cost inflation coming from China is actually sustainable in nature and has nothing to do with the geopolitics or the COVID or the supply chain issues it would simply be higher because the operating cost for your suppliers based out of China would have actually gone up if you could therefore sort of delineate as to how much cost inflation is coming from this factor and therefore is there to stay for the future and how much can sort of soften because of the transitory impact of some of these issues related to COVID and supply chain and so on.

Adhish Patil: Harit bhai would you like to answer this on the raw material side.

Harit Shah: What has happened in China over the years that chemical sector government is giving low priority now due to environmental issue and many industrial parks which were in near the cities have been asked to move to remote places and plus environmental norms have become more stringent and plus in addition to that the labor cost also in China is very high compared to vis-à-vis India now. So overall scenario if you are efficiently producing any product we can always compete China that is our philosophy we feel that we can always compete China basically.

Gagan Talreja: No, my question is that your procurement cost of the inputs coming from China not your competency versus the Chinese supplier I am saying since you rely very heavily on Chinese vendors for your inputs and some of those input costs would have gone up simply because the operating costs of your vendors based out of China would have gone up on a sustainable and permanent basis, which you therefore need to pass on to protect your margin right, some of the other input cost inflation is related to a sharp up move due to supply chain disruption caused by COVID and some coming from the sharp gas price movement so on. So I am simply trying to pass or separate out the impact between these two elements because one is sustainable going ahead and one is sort of something that can normalize and therefore trying to understand how much of the input cost inflation is actually now permanently set in the base and how much can go away?

Harit Shah: It depends on the product-to-product it differs basically but 10%, 15% pre-COVID level prior the cost have gone up that will be sustainable for future, that is a permanent cost gone up basically because many small producers have stopped producing in China so there are less producers for particular products.

Gagan Talreja: Have you seen the prices of intermediates and key starting materials soften over the last month or two for you?

- Harit Shah:** It is not from China but domestically yes some due to higher power cost this commodity price some chemical basic chemicals like nitric acid, ammonia, caustic soda, etc., which is very commonly used in all our APIs and chemicals has started softening now basically.
- Gagan Talreja:** The bulk chemicals I understand have softened I was sort of looking more for...
- Harit Shah:** Yes, intermediate price also a little bit softening yes.
- Gagan Talreja:** So final question from my side, in the products that you supply you said that you have not been able to pass on the input price increase having tried to do so you have lost out in volumes, if that is the case I am simply trying to understand is the supply or the capacity for supply for these products in the market well in excess of the demand and therefore even a very large and very cost competitive supplier like you has not been able to pass on?
- Harit Shah:** Yes, partly true, but what has also happened is last quarter our sales were very high and all the formulation companies started believing that this whatever growth was there in last two years will sustain so their formulation all distributor level everything their forecast was very high and they produced more in last quarter basically. So now more of destocking is happening in this quarter basically.
- Gagan Talreja:** It is therefore not sustainable since, it was basically a lot of channel inventory being replenished.
- Adhish Patil:** I will answer that question see what happened is we are able to pass on increased prices and that is why at least you can say more than 90% of the customers have broken at that high level maybe 10% or some customers have refrained from purchasing at that higher level probably because they might be the ones to have the better inventories in the last quarter. So they were able to refrain that purchase rather postpone that purchasing decision, but if it persists for longer period then even they will have to start buying at such high levels so more or less this impact is more in short-term nature than long-term nature.
- Gagan Talreja:** My dilemma is that for the last so many quarters it has been difficult not only for you but for the entire sort of API industry to pass on the input inflation in commensurate measure in output prices to formulation companies. This can happen only in the case where alternate supplies are available to formulation companies at lower prices, otherwise I fail to understand why this has been the case, even intermediate suppliers have managed to protect margin better than API suppliers, so I am simply trying to understand what has been the underlying reason for this, you are at least in three or four molecules have a larger supplier globally let alone in India and even then it has been very hard for you to pass input inflation in full measure or anywhere close to full measure so what else explains that?

- Adhish Patil:** What I can make out of it is only one thing that in the last five quarters prices have gone up to a large extent. If we take current quarter selling prices with respect to you can say last quarter's purchase prices then the margins will look fantastic, but right now it is not looking because again the escalation had happened at the input prices means in the month of February till April.
- Gagan Talreja:** I get that, but is it also a case that in the products that you supply at least for the domestic market most of them are under price control and therefore the formulation companies give you push back in and resist input inflation being passed on because they themselves can pass it on and because they are under DPCO?
- Adhish Patil:** Definitely that happens and they get escalations every year based on the inflation so if this kind of scenario persists then definitely there will be more escalations in the final prices.
- Gagan Talreja:** Yes, but it would be now has given a 10%. This year they have been given a 10.7% sort of...
- Adhish Patil:** But they work on last 12 months data so they also have a lot of lag in terms of numbers and obviously they will also be conservative in increasing prices. So if it persists like this then definitely they will have to look at it.
- Gagan Talreja:** Okay thanks a lot for taking my question. I will get back in the queue.
- Moderator:** Thank you. Due to time constraints we have reached the end of question and answer session. I would now like to hand the conference over to Mr. Adhish Patil for closing comments.
- Adhish Patil:** Thank you everyone for joining us on the call and having a full discussion. We look forward to interacting with you again with a bit of good set of numbers in the next quarter. Please reach out to us by our IR consultant SGA or directly to us if you have any further queries. We can now close the call. Thank you.
- Moderator:** Thank you. On behalf of Aarti Drugs Limited that concludes this conference. Thank you for joining us. You may now disconnect your lines.