Aarti Drugs Limited
Manufacturers of : Bulk Drugs & Chemicals

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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”, Bandra - Kurla Complex,
Bandra (E), Mumbai – 400051

**NSE SYMBOL: AARTIDRUGS**

Dear Sir/Madam,

**Sub:** Transcript of Q2 FY23 Earning Conference Call

Please find attached herewith transcript of Q2 FY23 Earning Conference call.

Kindly take the same on record.

Thanking you,

Yours faithfully,
**FOR AARTI DRUGS LIMITED**

RUSHIKESH VIVEK DEOLE
Digitally signed by RUSHIKESH VIVEK DEOLE
Date: 2022.10.31 18:05:34 +05'30'

RUSHIKESH DEOLE
**COMPANY SECRETARY & COMPLIANCE OFFICER**
ICSI M.No.: A54527

# "Aarti Drugs Limited
# Q2 FY2023 Earnings Conference Call"

## October 21, 2022

**Disclaimer: E&OE - This transcript is edited for factual errors. In case of discrepancy, the audio recordings uploaded on the stock exchange on 21st October 2022 will prevail.**

Management: Mr. Harshit M. 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

**Moderator**: Ladies and gentlemen, good day, and welcome to Aarti Drugs Limited Q2 FY2023 Earnings Conference Call. This conference call may contain forward-looking statements about the company, which are based on beliefs, opinions and expectations of the company as on 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 very much. Good afternoon, everyone. On behalf of Aarti Drugs Limited, I extend a very warm welcome to everyone joining us today to discuss our financial results for the quarter ended September 30, 2022. On this call, we are joined by Mr. Harshit Savla, Joint Managing Director; Mr. Harit Shah, Whole Time Director of Aarti Drugs; and Mr. Vishwa Savla, Managing Director of Pinnacle Life Science Private Limited; and SGA, our Investor Relations Adviser.

I hope everyone had an opportunity to go through the financial results, press release and investor presentation, which have been uploaded on the stock exchange and on our company's website.

In the quarter gone by, the pace of civil construction activity for the Gujarat capex has picked up considerably towards the end of Q2 FY 2023, which remained affected at the beginning due to monsoon season. The company is well on track to make this facility operational by the end of Q1 of FY 2024. We are resolving few scale-up issues of Tarapur Brownfield capacity installed in this financial year, and we expect this facility to start contributing to the top line from H2 FY 2023 onwards. Apart from this, Tarapur API Greenfield capacity is also expected to be completed by the end of FY 2023. The total capex during H1 FY 2023 stood at INR 77 Crores and is expected to be in the range of INR 200 Crores to INR 300 Crores for the entire FY 2023.

Coming to capex for formulation segment - expansion at Baddi plant is nearing completion. We are building an oral oncology manufacturing facility. The total planned capex including product development expenses is budgeted at INR 55 Crores, out of which around INR 40 Crores is done. We expect plant to commence commercial operations in March 2023. At full capacity, the plant can generate revenue of INR 200 Crores. Products manufactured in this site will be majorly new age oncology drugs with patent expiry in coming few years. The business model for the unit will be a mix of contract manufacturing and own portfolio.

Coming to our performance during the quarter. The company achieved a healthy top line growth in spite of geopolitical uncertainties, adverse currency movements across the globe, macroeconomic volatility and sustained inflationary pressure on some operating costs such as power and fuel expenses. This growth was made predominantly by higher realizations in API and Specialty Chemicals segment. During Q2 FY 2023, the company witnessed the highest ever realization in most of the API and Specialty Chemical products, along with softening of some input costs barring power and fuel costs. We expect further moderation in the input cost going forward, which can further aid the operating margins.

The company's operating cost were marginally up during the quarter due to increased power and fuel cost and one-time arrears paid to the employees and labor contractors. Finance costs also inched up higher due to higher interest rates and increased working capital requirements due to higher inventory.

With respect to our performance across our segments for the quarter, API segment, the largest segment of the company in terms of revenue contribution, grew 17% Y-o-Y. As stated earlier, the growth was mainly driven by an increase in selling price with an 11% volume both in export market and marginal volume growth in domestic market. We anticipate a healthy growth for this segment, along with a sustainable increased profitability on the back of operating leverage, ongoing capex, backward integration and falling raw material prices.

Revenue from the Formulation segment stood up at INR 82.5 Crores for the quarter, up 9% Y-o-Y. The Formulation segment's share of the total revenue for the quarter was around 12%. The Formulation segment's core focus area continued to remain export. During the quarter, exports contributed around 44% of the total revenue.

Now coming to Specialty Chemicals, Intermediates and others. This segment continues to remain the fastest-growing segment of the company. The growth in this segment is mainly driven by capacity augmentation along with presence in niche product category of chloro-sulphonation, a few other contract manufacturing products. We expect the growth to remain in upward trajectory over the next few quarters for this segment.

Coming to overall stand-alone performance for the quarter. Standalone revenues for Q2 FY 2023, stood at INR 624.9 Crores as against INR 511.6 Crores, showing a growth of 22% on Y-o-Y basis. The stand-alone business contributed around 88% to the consolidated revenue for the quarter. Approximately 62% of the revenues came from domestic market and approximately 38% from the export market for Q2 FY 2023 for the stand-alone business.

Domestic revenue grew approximately by 19%, while exports grew by around 28% year-on-year basis for Q2 FY 2023.

Within the API segment, the antibiotic therapeutic category contributed around 44%; antidiabetic around 17%; antiprotozoal around 16%; anti-inflammatory around 10%; antifungal around 8%; and the rest contributed around 5% to total APIs for Q2 FY2023.

Going ahead, we remain confident of continuing our growth trajectory driven by capacity expansion through a combination of Brownfield and Greenfield capex in API and Formulation segments and sustained momentum in our Specialty Chemicals segment. The profitability and return ratios are also expected to include in tandem owing to operating leverage and backward integration. The company will continue to explore various opportunities in terms of new therapy addition and geographic expansion.

With this, we can now begin the question and answer session. Thank you.

**Moderator**: Thank you very much Sir. We will now begin the question and answer session. The first question is from the line of Rashmi Sancheti from Dolat capital. Please go ahead.

**Rashmi Sancheti**: Thank you for the opportunity. My first question is that higher realization in the API and the Specialty Chemicals segment, and then we are also talking about moderation in the KSM. We are still seeing the quarter-on-quarter drop in the gross margins so any specific reason behind that, any kind of forex loss or any other reason for such a drop?

**Adhish Patil**: Yes, actually, for a few of the KSMs, the market has been very volatile from January till date. And the thing is based on these macro situations we had piled up inventories also. So in some cases, we had purchased at a very high rate. If you see the ongoing negotiations on the raw material and selling prices for a few products, we can easily see 3% to 4% better margins. But then when it comes to taking the inventory loss on the accounting part, it is coming down. That is the main reason why still we are not able to show it in the rates.

**Rashmi Sancheti**: And there is no forex loss element right.

**Adhish Patil**: Forex loss notionally is around 2 Crores so not much.

**Rashmi Sancheti**: Not much. Okay. And so earlier in last quarter, we said that from the second quarter onwards, we will be seeing improvement in the operating margin from the second quarter. But I think it was more or less similar to the first quarter only. And our first half EBITDA margin is around 10.8% now. In the second half, how do you see this operating margin and gross margin going forward and for this full year, if you can give any direction or any guidance on it?

**Adhish Patil**: Okay. So one first, the September quarter versus June quarter, in the API segments the EBITDA margin improved from 10% to 11.2% though on consol level as you correctly pointed out, it has remained same. Formulation segment has performed much better in the June quarter as compared to September quarter. That is why on the consol. level, the EBITDA margin still came the same. However, the improvement in the stand-alone EBITDA margin was also attributed to more efficiency in the manufacturing expenses rather than the gross contribution. So the manufacturing expense, anyways, we feel we might incur a bit further too, but the main area for us is to improve the gross contribution. And we think it will improve with the stability in the price movements. If the volatility goes away, the margins should improve considerably. And going forward, we at least expect around a couple of percent improvement going forward. And they will keep improved scenario becomes stable once all the inventory losses goes away, then the margin should improve. So at the end, we should try to, by the end in Q4, we should try to get EBITDA margins upwards of 15%.

**Rashmi Sancheti**: Okay. Got it. That is helpful. And on your Formulation business, If I see that in this quarter also, we have done only 9% growth. Despite we have done majority of the exports in the formulation business. Still, it is not contributing big to the EBITDA so any comments on that?

**Adhish Patil**: Yes. Vishwa, can you please answer this question?

**Vishwa Savla**: Last quarter, we had a much better EBITDA. So some of our high-value, high-margin exports, we were not able to execute in the current quarter due to which the margins were low. However, we would be able to execute those orders in the coming 2 quarters. So on a year-on-year basis, we do expect the margins to recover and EBITDA margins to improve once we have to put our higher margin export.

**Rashmi Sancheti**: Okay. And my last question is on Metformin. If you could update on how the price is moving for the Metformin in the export market as well as in the domestic market, whether the prices are going up or it is coming down and also, if you can update on your additional capacity. Any new production from that additional capacity for Metformin has started, what is the current total capacity installed now? And how much is the utilization rate?

**Adhish Patil**: I will answer your second question first. So last quarter, we have done very good sales for Metformin. So our average capacity is around 1,150 to 1,200 tonnes per month. And we were able to achieve somewhere around 1,000 tonnes per month of sales, for the last quarter, that is. And regarding price movements, I will ask Harit bhai to answer that question.

**Harit Shah**: So the price of major raw materials, DCDA, which is a major raw material for Metformin, has come down quarter-to-quarter. So at the peak of the beginning of the year, it was around $4,000 to $4,500. So now it has come down to less than $3,000. So we expect price to stabilize around these levels and then price of Metformin will also stabilize. So these 2 quarters, the price keep on reducing and we had a lot of inventory loss because of that. But now things have stabilized, more or less.

**Rashmi Sancheti**: I have more questions, I will get back in the queue. Thank you so much.

**Moderator**: Thank you. The next question is from the line of Ranvir Singh from Edelweiss Wealth. Please go ahead.

**Ranvir Singh**: Thank you for taking my question. One thing, you commented EBITDA margin of 15%. So this is the overall EBITDA margin you are talking about? Or only API part, you said and secondly yes, you can continue, then we will have another question.

**Adhish Patil**: Yes, on an overall basis, but also on the API side because almost stand-alone business is contributing around 88% to the total revenues. So more or less, it will go hand-in-hand.

**Ranvir Singh**: Okay. Yes, fine. So in this quarter, whether we have any contribution from intermediate facility, any new projects we are working on.

**Adhish Patil**: I did not understand your question.

**Ranvir Singh**: That new products were supposed to intermediate facility was suppose to start contribution.

**Adhish Patil**: Correct. So that Brownfield expansion, what we had done in Tarapur for Specialty Chemicals, we are still not able to fully ramp up the capacity since you can say almost 30 tonnes out of 400 tonnes, we are not cutting around 60 out of 400, we have achieved. But in November, we will be achieving upwards of 150 out of 400 tonnes per month. There are a few issues related to scale-up batches, but we know how to resolve that just that we are waiting for a few equipment to come in and then we will be ramping up the production. And as far as the consumption norms are concerned, we feel that we will be surpassing our previous norms because earlier we used to do a batch manufacturing process, and now we will be doing continuous manufacturing for that particular product with different Route of Synthesis. So RMC will also be completed for that project.

**Ranvir Singh**: So for FY 2024 perspective, I think we expect a meaningful revenue coming from this.

**Adhish Patil**: So this full scale potential for this facility will be anywhere between INR 90 Crores to INR 105 Crores.

**Ranvir Singh**: Okay, okay. And that should be achieved by?

**Adhish Patil**: So because it is Specialty Chemical and we have been dealing in this, we will try our best to ramp up as soon as possible. So by the end of next year, hopefully we should be occupying it by the end of next financial year. But how much time it will take, we also are not very clear on that, how much we will get for the next entire year.

**Ranvir Singh**: Okay. And any update on the gliptins facility we are working on?

**Adhish Patil**: Yes. So there, we have taken commercial batches. We have started selling our product in the market so that the quality acceptance is there. And now we are working on the reduction of cost, and there are few intermediates also on which we are working. So we will be handing over the process to a few of our exclusive jobwork manufacturers for the intermediates. And that will help us to reduce the cost and become ever more competitive. So though top line, it will start contributing. But bottom line, I should say it will take at least 2 quarters to start contributing meaningfully.

**Ranvir Singh**: Okay. Fine. And if in API, in overall perspective, your commentary said that inventory purchased earlier is still with you. So when that inventory is likely to exhaust? So in Q4, you said that improvement will happen. So this is based on the new price negotiation you have started?

**Adhish Patil**: So if everything remains stable, by next quarter it should be over. I mean, by the next quarter mean Q3.

**Ranvir Singh**: So from Q3 onwards some improvement should start visible there.

**Adhish Patil**: Yes.

**Ranvir Singh**: Okay fine that is it from my side and all the best.

**Moderator**: Thank you. The next question is from the line of Priya Harwani from Perpetuity Ventures. Please go ahead.

**Priya Harwani**: Thanks for the opportunity. So I just wanted to cross-check the number of capex mentioned in the commentary. So can you repeat that?

**Adhish Patil**: Yes. We said that around Rs.77 Crores has been done for this year. And what we hope that it will go around Rs. 200 Crores to Rs.300 Crores for this entire year because what has happened is we have ordered a lot of equipment for 2 of our Greenfield projects. So when you order, typically, you give around 15% to 20% advance. But when the delivery will come in, at that time, the outflow will be higher. So we expect that second half capex are much higher than the first half of the FY 2023.

**Priya Harwani**: Got it. Thank you so much.

**Moderator**: Thank you. The next question is from the line of Parth Vasani from TK Advisors. Please go ahead.

**Parth Vasani**: Thank you for the opportunity. Actually I have couple of questions. First one would be how much revenue can we expect from the recently commissioned capex for the entire FY2023?

**Adhish Patil**: So you are asking how is the total revenue potential of the existing capacities right.

**Parth Vasani**: Yes.

**Adhish Patil**: So based on the last quarter prices, we can do upwards of INR 3,000 turnover even for the stand-alone company itself. Yes, so around upwards of INR 3,000 Crores for stand-alone company. And then we can add another INR 300 Crores for Formulation. So that will be a full scale potential for existing capacities. But then there are more capacities which are coming up in Q4 and then Q1 of next financial year.

**Parth Vasani**: Yes, that was helpful. Second, I wanted to ask that in the press release, you have mentioned about the increased requirement for working capital. So can you explain the reason for the same?

**Adhish Patil**: Yes. So the thing is our inventory has gone up, no doubt about that. So that is why we have reduced, we might reduce our production a little bit. But until September, we did not reduce on the production, even though demand for few of the antibodies was a little less on the domestic market. On the export side, we are seeing good demand. But for the domestic market, the demand was a little subdued. And usually, monsoon season, the demand is good. So we kept on producing. So that is the reason why the inventory was piled up a little bit. And also because the macro factors where because of this war scenario and others and everything, it was quite unclear. So we did not want to lose on production so that is why we kept on producing. But now going forward, I think by reducing for some of the products, we might bring down the inventory and then the working capital will be freed up again.

**Parth Vasani**: That was it from my side. Thank you very much.

**Moderator**: Thank you. The next question is from the line of Rashmi Sancheti from Dolat Capital. Please go ahead.

**Rashmi Sancheti**: Thanks for the follow up. Just one question on gliptins, which we have started last year, last quarter, Q4 where are we in terms of both Teneligliptin and Vildagliptin and have you started any exports for the gliptins?

**Harit Shah**: So Teneligliptin, we are more or less production is stable. Our cost efficiency has improved, and we are working on making intermediates ourselves. So we are already going to get, we are improving our market share in domestic market, and export for this product is not substantial but we are concentrating getting more and more Indian market by another 1 or 2 quarters. And about Vildagliptin, we have just started export marketing and started submitting samples and validation batches, etc. So most only another 2 quarters, Vildagliptin we will be able to export more volumes, yes.

**Rashmi Sancheti**: Sir, if you all an update on the Specialty Chemical Greenfield plant. Where are we currently? Are we on track to start the production at the end of FY 2023?

**Adhish Patil**: For the Greenfield plant of Specialty Chemicals, that is for backward integration, which we are doing in Gujarat, the estimated start the commissioning of the equipment and the trials will be taken towards the end of first quarter of FY 2024. That is the June quarter and the Tarapur Greenfield one we are expecting to start by March.

**Rashmi Sancheti**: So Tarapur Greenfield one, the chloro-sulphonation?

**Adhish Patil**: No. So there are 3. There are 2 Greenfield projects which are going on. One is Specialty Chemicals at Gujarat, that is the Greenfield. There is a second derma project, Greenfield project which is going on in Tarapur. And the third was the Brownfield expansion of Specialty Chemicals in Tarapur. It is already done.

**Rashmi Sancheti**: The Specialty Chemical, the chloro-sulphonation one and the entire Specialty Chemical, that is in Gujarat, you are saying?

**Adhish Patil**: So there are little changes there, so the chloro-sulphonation one which we were planning to start at Gujarat, so it was a 10x scale up from our existing batch manufacturing project. So initially, what we had done a Brownfield expansion in Tarapur itself with 5x scale up, not the 10x, 5, 5x scale up. The ultimate plan is to shift the entire production to Gujarat. But the current Gujarat expansion which is going on, that is more on other intermediates, not the chloro-sulphonation.

**Rashmi Sancheti**: But maybe after 1 year or something, this chloro-sulphonation where you have started the Brownfield will get shifted to ultimately to the Gujarat Greenfield Specialty Chemical plant, right?

**Adhish Patil**: Yes. And that will be the second site. The current Greenfield site which is going on, that is different. And this will be the additional Greenfield site, which we will be putting in Gujarat.

**Rashmi Sancheti**: Understood. That would be the new lines basically.

**Adhish Patil**: Yes.

**Rashmi Sancheti**: Okay, thank you for the clarity that is it from my side.

**Moderator**: Thank you. The next question is from the line of Priyanka Shah from Athidhan Securities. Please go ahead.

**Priyanka Shah**: Thank you Sir for the opportunity. I have a couple of questions. Sir, can you bifurcate capex for API and Specialty Chemicals for FY2023 for INR 200 Crores to INR 300 Crores capex?

**Adhish Patil**: Okay. So on a broader scale, some of it, say, around INR 40 Crores, INR 50 Crores would be the Brownfield and your maintenance-related capex. But the majority of it is almost 50-50 at Tarapur Greenfield and Gujarat Greenfield projects.

**Priyanka Shah**: Okay, Sir. And what is the current capacity utilization for API and Specialty Chemicals?

**Adhish Patil**: So current would be somewhere in mid-70s only.

**Priyanka Shah**: Thank you so much Sir.

**Moderator**: Thank you. The next question is from the line of Ranvir Singh from Edelweiss Wealth. Please go ahead.

**Ranvir Singh**: Thank you for follow up. Just on capex side, you said in first half, how much capex we have spent and how much remains to be spent in second half of FY 2023?

**Adhish Patil**: Yes. So the first half, we have done almost INR 77 Crores. And by the end of the year, we expect it to remain between INR 200 Crores to INR 300 Crores. Now the reason we are in such a broad range is because it might just go in April. So that is I am giving a range of INR 200 Crores to INR 300 Crores for the entire year.

**Ranvir Singh**: For the entire year, okay. So of that INR 600 Crores total capex, we are half in FY 2023.

**Adhish Patil**: Yes. So the 2 Greenfield projects with almost INR 350 Crores kind of capex that will be completed by, you can say, June of 2023, June month of 2023. Most of the capex, which is like INR 350 Crores to these 2 Greenfield projects will be completed.

**Ranvir Singh**: And remaining would be in 2024.

**Adhish Patil**: Yes, correct in FY2024.

**Ranvir Singh**: By end of FY 2024, yes. Okay. And there in backward integration side, right now because for the last few quarters we have been talking that we are working more on backward integration side. So any new development you could highlight that we have achieved in this first half of FY 2023 on the integration front?

**Adhish Patil**: Yes. So that plant will be completed by around May or June in 2023. That is first quarter of next financial year. So after that, we will start utilizing the production from the intermediate facility.

**Ranvir Singh**: And this is related to which product?

**Adhish Patil**: This will be broadly related to antidiabetic and other antiprotozoal.

**Ranvir Singh**: Okay, okay. And projects are under the PLI scheme, so what is development there for DCDA?

**Adhish Patil**: No so DCDA we are not going ahead as of now. DCDA currently we are not doing we are in putting that.

**Ranvir Singh**: So that project has been cancelled.

**Adhish Patil**: No. No, actually, DCDA project, we never announced. PLI scheme there was another project from antiprotozoal. So we are doing it, but we are not going for PLI scheme, the reason being the capex which we had committed earlier, that got reduced substantially almost by 50%. And we approach government that whether it will be okay for them. But they say that we have to do the committed capex to be eligible to get that benefit. So we decided that rather than spending that much, we will spend less upfront and still implement the capacity. But we are doing that project, but we are not going in we are giving up the PLI benefit because we are getting everything in capex.

**Ranvir Singh**: Okay. And the API related to skin, the dermatology segment, I think that was an import substitute. So have you seen any competition there or pricing? Because we are a little delayed there?

**Adhish Patil**: So as of now, there is no substantial domestic competition for that. So the only competition will be from China.

**Ranvir Singh**: Okay, thank you.

**Moderator**: Thank you. The next question is from the line of Harsh from Marcellus. Please go ahead.

**Harsh**: Hello Sir, with the chloro-sulphonation project moving to Tarapur, what exactly Greenfield expansion are we doing in Gujarat facility?

**Adhish Patil**: Yes. So Greenfield, that is we are doing a few special I mean, sort of intermediate, you can say, on specialty side. It will serve as a backward integration for our other main products. Chloro-sulphonation, we will be putting in the second site of Gujarat.

**Harsh**: The current Gujarat facility how much are we doing the capex.

**Adhish Patil**: So that will be roughly around INR 150 Crores to INR 200 Crores.

**Harsh**: Okay, okay. And this facility is likely to commence production in Q1 FY 2024?

**Adhish Patil**: Correct, by the end of that by the end of that quarter.

**Harsh**: That is it from my side. Thank you.

**Moderator**: Thank you. The next question is from the line of Niharika from Aequitas Investments. Please go ahead.

**Niharika**: Good afternoon. So I think you mentioned that volume growth has been flat in domestic market, and I think some 10% to 11% growth in export markets. So with all the API capex that is coming into picture, how are we planning to like ramp up? Like where are we seeing the market for its export or domestic? Because I see the domestic is still flat?

**Adhish Patil**: Yes. So the capex also which we have planned, that is for additional products. So there will be right now so basically, the market will be new for that and for the current, you can say, 20%, 25% underutilized capacity for few of the existing API products. We have the visibility the domestic market will pick up. One is that. And secondly, there are a lot of small export geographies you can say. For each product, a bit of it is left out. And also, we are having a lot of European focus and to update on that, recently, recent limits in this week itself, 1 of the facilities of Tarapur, the E22 facility, we just had an EDQM inspection with the European authority. It was quite good. So the report will come out in a few days, and then probably do a press release on that as well. So European market, and there are a lot of other geographies where we can increase the sales.

**Niharika**: Okay. And for the new Greenfield Tarapur facility, are we also going for any U.S. FDA approval, the new facility which is coming? Are we also planning to go for…?

**Adhish Patil**: The Greenfield, no. But for the existing antidiabetic facility, which we will be expanding further in next year, there we are planning to get an U.S. FDA approval. And that is a dedicated plant. The current one was a multipurpose one.

**Niharika**: Okay. And on the Gujarat Greenfield, you said that it is majorly for backward integration. So it ideally would just reduce my operating cost. Basically, this is 100% for captive consumption? Or are we also going to sell it to outside parties as well?

**Adhish Patil**: It is both. It is a mix of both. So the thing is the entire capex plan, which we had, the INR 500 Crores, INR 550 Crores, the external revenue potential was somewhere between INR 1,500 Crores to INR 1,600 Crores. Sorry, the actual revenue potential from those, right, but the external revenue potential was only around INR 1,200 Crores. So the rest was the captive part.

**Niharika**: Okay. So INR 1,200 Crores so percentage-wise, some 60%, 70% would be captive and rest would be…

**Adhish Patil**: Okay. So if you are asking only of the Gujarat facility, what you say is correct.

**Niharika**: My last question would be on inventory, so inventory still on a very higher side. And is it majorly the finished goods that is held up in our stock? Or is it also the raw material? Because I think raw material we were shedding off in last quarter as well. So this INR 500-odd Crores inventory, does it constitute majorly of finished goods?

**Adhish Patil**: Yes. So what has happened that in last quarter, our production was very high. In fact, we have a 10% volume growth in terms of production as well for the last quarter. So whatever raw material inventory pile-up was there, we have now by the end of last quarter, we have now converted it to finished goods. But now it will start scaling back.

**Niharika**: But are you taking inventory loss on the finished goods that is in the stock? Or are we able to make any margins on that because I think this by using the high price raw materials.

**Adhish Patil**: Yes. So as of now for the finished goods, there was no inventory loss. But because we follow that FIFO method for raw material costing, so the higher value raw materials have been accounted in the September quarter. But as you correctly say, that the newer stock will have a little less RMC because of the falling raw material prices. But then there will be some impact in December quarter as well because of...

**Niharika**: Thank you. That was it from my side.

**Moderator**: Thank you. The next question is from the line of Aditi Sawant from ADM Advisors. Please go ahead.

**Aditi Sawant**: Thank you so much for the opportunity. I have one question. The total expense in Formulation, can you please share how much is the developed markets and how much is for emerging markets?

**Vishwa Savla**: Yes. As of now, majority of it is for emerging markets because in regulated markets, we are yet to receive our approval in registration in the last 2 years or 2.5 where we have been focusing on regulated markets so most of our regulated market pricings are either in pipeline or under approval stage. So as of now, a majority of the revenue is coming from the emerging markets.

**Aditi Sawant**: Thank you that was helpful. That is it from my side and all the best for the upcoming quarters.

**Moderator**: Thank you. The next question is from the line of Esha Sawla from Arya Securities. Please go ahead.

**Esha Sawla**: I just wanted to ask a few questions. So first of all, I would like to understand that we have witnessed highest ever prices for retail products So my question is, do we expect the realizations to fall as the input costs have started to come up?

**Adhish Patil**: Yes, it will happen slowly because that is true. Because most of the time, API prices follow the input prices. So because across the board, slowly, the raw material prices will start going down, the API prices will come off slowly.

**Esha Sawla**: Okay. What kind of time lag do you expect to have?

**Adhish Patil**: So it will depend on how much I mean, order book you have piled up, but typically 1 to 2 months, you can say.

**Esha Sawla**: Understood. And secondly, how much is the current differential between domestic and export API prices?

**Adhish Patil**: Okay. So again, product to product, it is different. But definitely, the export prices are high. In some cases, it is a lot higher than the domestic cases. But there also in exports also, it depends on which geographies we are selling. So the Indian subcontinent like Pakistan, Bangladesh and so on, there the prices will be very low or few emerging markets of

Southeast Asia. But otherwise, in other geographies, the prices are much higher than domestic market. It is very difficult for me to quantify. I am not able to quantify that.

**Esha Sawla**: Got it. The next question, I just wanted to check that are we planning to diversify Specialty Chemical business away from our chloro-sulphonation products with the ongoing capex?

**Adhish Patil**: Yes, so we are definitely doing more on the specialty chemical side other than chlorosulfonation also we are expanding in other lines as well we are also doing contract manufacturing projects with our MNCs in this field and the Gujarat facility will also add new products in this specialty chemicals line.

**Esha Sawla**: This is very helpful. Thank you for answering all my questions.

**Moderator**: Thank you. The next question is from the line of Gagan Thareja from ASK Investment Managers. Please go ahead.

**Gagan Thareja**: Sir, the first question is on the margins. Throughout the last 12, 15 months, not just Aarti, but all API companies have struggled with margin contraction. The reasons given out largely centered around high input prices and difficulty in passing the input prices on completely, also there were freight and utility price increases. Now RM prices are softening and you yourself indicated that in a couple of months, finished good prices will also sort of fall in line. So I mean, if that is the case, then what are your views for margin expansion? You are saying that you are probably going to exit the final quarter of this year at 15%. How will that happen if your output prices also fall in line with input?

**Adhish Patil**: Yes. Actually, as I was explaining earlier, you correctly pointed out those utility prices have also gone up. And apart from gross contribution, other major impact which API players are facing as compared to last financial year. Especially for the first half that is, is because of the coal prices. So the prices have more than doubled. I mean, they have remained like that for the long period. We hope that to come down. And what has happened indirectly because of these very high coal prices, now the power rates have also gone up because of thermal power stations because they also rely on coal. So there, also because of that also manufacturing utility costs have gone up quite considerably for manufacturing companies, I would say and as far as this gross contribution is concerned, as I was explaining, the negotiations which are happening, so if you take any particular month, the margins looks higher, but the problem is in the uncertain scenario of last 9 months, what has happened that we end up booking a lot of raw material at a higher price. And the sales order comes, you can say more or less, spread out every month. So sometimes there is a problem in terms of you might end up booking a high-priced raw material and then the prices start falling in. So once this volatility goes away, what we are trying to point out is that even if volatility goes away, the margin should expand once all the inventory losses are taken into account.

**Gagan Thareja**: But are you saying that the expansion from 10% margin to a 15% margin, that is very significant.

**Adhish Patil**: Yes, yes. So API, already we are 11.2% right now. It would still mean another 400 basis point's improvement.

**Gagan Thareja**: But is that all down to simply the lead in lag between are you holding out higher cost inventory and RM prices pushing down and therefore, we are looking inventory loss. Is that the only reason why your margins have sort of if I look at the longer-term trend for Aarti, the 4- 5-year average margins would be on the 15% mark and if I go back further into the past, probably still higher? I mean, if one keeps that sort of a perspective in mind, I understand short term, there is volatility and there are business cycles. But if it hits you so much and so badly...

**Adhish Patil**: Actually, there is one more factor regarding ammonia-related products. I think Harit bhai will be better able to explain you that.

**Harit Shah**: Yes, yes. Overall, because of gas shortage, Russian-Ukraine war, the price of ammonia is almost 3x of 1 year back. And we do not see any correction in the immediate future because of supplies of gas from Russia. So fertilizer plants across the Europe almost are affected. So they would rather put their energy into electricity than making fertilizers. So that is the theme. But otherwise, all other chemical prices are coming down. I say 1 or 2 stray cases, but overall situation looks good now.

**Adhish Patil**: And the same products are available at much cheaper rates in China. So the Chinese manufacturers which are our main competition in a lot of products, so they are having that price advantage in terms of raw material rates. And that is also one of the reasons for a few products are margin getting squeezed.

**Gagan Thareja**: Okay. I would have thought normally that whatever you indicated on ammonia prices and utility you essentially just pass on the absolute cost increase, you do not get to retain the same percentage margin, right? If your costs have gone up by, let us say, on a base of 100 by 20, you pass on 20, you do not pass on the margin on that, right? So if that is the case then...

**Adhish Patil**: What you say is correct, absolutely correct in terms of short term because in short term, means within a year, API players do only get you can say the value addition per kg. But in longer run, when we close down the financial revenue, we see the returns. And then ultimately, for any business or any competitors as well, margins are very important. So that is the time when margin again started getting back to normal. Yes, what I am trying to say is, suppose very roughly, suppose we are making INR 200 on a INR 2,000 product, and

INR 100 product, even INR 20 is okay for you. So basically, margins are important, what I am trying to say. It is not across otherwise, what will happen even for the INR 10,000 product, if your API starts expecting only INR 200, then margins will go for a toss. So ultimately, it will come back to margins in the longer run.

**Gagan Thareja**: Okay, okay. But are you seeing your competitors sort of also not trying to break the market up for volumes and therefore, your expectation that you need to...

**Adhish Patil**: Yes. It might happen because if suddenly demand goes down, I mean, everyone was expecting higher, we can say, demand. And everyone has produced a lot of quantity, and suddenly, the demand goes down. Everyone is losing.

**Gagan Thareja**: In your assessment is the inventory in the supply chain, I mean, I do not know how one gets a handle on that. We do not have any ways to do that. But would you believe that the inventory situation in the channel is normal, and therefore, such issues may not arise going ahead.

**Adhish Patil**: So based on the feedback which we get from the market, I think the orders should start coming back. But Harit bhai can better...

**Harit Shah**: Yes. Overall pharmaceutical demand was less in first 2 quarters and there were a lot of inventory. But now inventory things are back to normal, But we expect demand to go up people have started moving out and COVID-related issues no more there. So we expect demand to go back to normal before COVID levels, at least. Yes.

**Gagan Thareja**: I mean, if you look at the Chinese situation, there is a new Omicron variant and there is another set of rolling lockdowns happening in China again. You sort of are saying that things all stable going ahead, the scope for margin improvement. But it is these are the way they are in China, the supply chain will probably be disrupted once more. And there is already, as you indicated, a gas and ammonia disruption based out of Europe. So do you really see any stability in the supply chain coming in the next 2 quarters? Because I would have thought we are up for another wave of difficult Chinese supply chain.

**Adhish Patil**: So what you say is, see, we feel that if any additional negative impact comes out in terms of macro factors, then definitely the situation might remain same because that is the exact reason why the margins are lower even now. Last financial year also, the margins were quite low during the first half of the year and then in December quarter, the margins had gone up to 14%, 15% in December 2021 and then again, this war thing happened and again it got squeezed down. So the thing is if further negative factors happen, then definitely no one can know but assuming that things will stabilize here on because we have seen some correction in the raw material prices also. So if we assume that things will stabilize, then definitely our margins will start expanding.

**Gagan Thareja**: To what degree are you backward integrated in your current sales? And post-Gujarat to what degree does that increase?

**Adhish Patil**: Yes. So after Gujarat, another, you can say, 10%, 12% of our finished sale will be further backward integrated, you can say. But other than that, for most of the products we are more backward integrated than our Indian counterparts in most of the cases. And that is the reason why we have an edge over our Indian manufacturers. But definitely, even when it comes to Chinese manufacturers, we have captured a lot of their market share in Southeast Asian markets as well but only the few things about ammonia. And that has affected only the Indian players and not the Chinese players. So there, it is slight out of our hands, though even though our efficiencies might be at par with them or even better. But then because of the raw material pricing disparity, they are having some advantages over there. But in that case, we are approaching government for antidumping duty because the Chinese manufacturers are getting undue advantage. So yes, let us see how things pan out. But we are quite confident that it should improve. I mean, how fast it could improve, we should see now.

**Gagan Thareja**: I gather one of your peers is backward integrating into DCDA. This is something that almost all the API manufacturers buy out of China. I mean, if that is the case, do you see sort of this initiative on their behalf sort of causing market ripples and there will be a market share movement based out of their competencies which they get from backward integration?

**Adhish Patil**: Yes, definitely, it will help and even to start manufacturing DCDA, especially Metformin player but it is quite a tricky product and the chemistry is quite hazardous. So let us see because a lot of people have tried that project in past as well, but have not gone ahead.

**Gagan Thareja**: But you do not consider it a positive?

**Adhish Patil**: We will means obviously we have to keep an eye on that because otherwise we might have to go in-house because we ourselves will be having where we are wanting to have almost 3000 tons per month production of Metformin so it is quite a lot.

**Gagan Thareja**: Thanks that is all from my side.

**Moderator**: Thank you. The next question is from the line of Niharika from Aequitas Investments. Please go ahead.

**Niharika**: Just one another follow-up question; I just want to understand how are the long-term supply contract structured and also like I want to understand long-term contracts from a buyer perspective as well as supplier perspective, basically, is there any like is it fixed or any escalation clause?

**Harit Shah**: Sorry I did not get the question.

**Niharika**: I just want to understand how are our long-term supply contract structured and also how like as a buyer and as a supplier, how are the contracts structured.

**Harit Shah**: Normally, we have volume contracts and prices due to volatile situation, we have decided to offer quarterly pricing only and quantities and volumes are fixed, and based on this quarterly raw material pricing situation, we change our pricing for the next product for long-term contract.

**Niharika**: And is it linked to any, say, particular commodities, say, ammonia?

**Harit Shah**: Yes, yes, yes. So each product has a different. We are making 20 bulk drugs more than 20. But 80% of volumes come from Metformin. On that each product has different raw materials in sorry, different raw materials.

**Niharika**: So we are linking into some raw material prices I am just asking you there is a volatility that you have?

**Harit Shah**: Yes, correct.

**Niharika**: My second question is considering Aarti Drugs has like in few APIs, we are the largest players in like the domestic and some globally. So what kind of pricing power do we hold because still we are not able to pass it on fully. So why do not we have that kind of a pricing power because API is a very essential item. So why have not we…?

**Harit Shah**: No. The issue is the pricing are so volatile every month, the price valuation is as high as some products, is as high as the 10%. So how do we control that? But now things are better, and we expect if prices are stable, then we will definitely go back to our normal margins, yes.

**Niharika**: I am just trying to understand, why are not you able to like take the price hike? Because if there is some other competitors which is taking our share or because without API, even though like other than player cannot work. So then why cannot we have that kind of a pricing power. Is there some competition which you are seeing?

**Adhish Patil**: The thing is we are taking price hikes. So that is the reason why the September quarters selling prices are at maximum. But the thing is, are the price hikes, while taking the prices, it needs to be a gradual process because if we suddenly increase the price, generally formulator will get back, to try to look for other sources. And if someone else is having inventory during that period of low cost, then they will offer them. Then you might end up losing those orders in that particular quarter, too. But next quarter, again, both the competitors will come at a level playing field and then the prices will go. So these things happen on a temporary basis, but yes.

**Niharika**: Thank you.

**Moderator**: Thank you. As there are no further questions from the participants I now hand the conference over to Mr. Adhish Patil for closing comments. Over to you Sir!

**Adhish Patil**: Thank you, everyone, for joining us today on this earnings call. We appreciate your interest in Aarti Drugs Limited. If you have any further queries, please contact us or SGA, our Investor Relations. Thank you.

**Moderator**: Thank you. Ladies and gentlemen, on behalf of Aarti Drugs Limited that concludes this conference. Thank you all for joining us and you may now disconnect your lines.