



“Aarti Drugs Limited Q1 FY-21 Earnings Conference Call”

July 27, 2020



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: Ms. Cyndrella Carvalho - Centrum Broking Limited

Moderator: Ladies and gentlemen, good day and welcome to the Aarti Drugs' Q1 FY21 Earnings Conference Call hosted by Centrum Broking Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I would now like to hand the conference over to Ms. Cyndrella Carvalho from Centrum Broking Limited. Thank you and over to you, ma'am.

Cyndrella Carvalho: Good afternoon everyone. On behalf of Centrum team I, Cyndrella Carvalho, thank the Aarti Drugs' management team for giving us this opportunity to host this Quarter 1 FY21 Earnings Con-Call. From Aarti Drugs' management team we have with us today Mr. Harit Shah – Whole-Time Director; Mr. Adhish Patil - Chief Financial Officer; Mr. Vishwa Savla – Managing Director-Pinnacle Life Science Private Limited. At the outset I congratulate the management team on delivering excellent earnings in these unprecedented times.

I now handover the con call to Mr. Adhish for their opening remarks.

Adhish Patil: Good afternoon all. Thank you for joining the conference call of Aarti Drugs Limited. Management welcomes you all. The main purpose of the call is to brief you about the quarterly performance of the company and the current market conditions for the business. In the June 2020 quarter the company recorded consolidated quarterly revenue of Rs. 544.67 crores with year-on-year increase of 34.34%.

The API segment contributed approximately 85% and formulation around 15% of the total consolidated revenue. Within API segment 65.11% of the revenue came from the domestic market and 34.89% from the export market. Domestic sales of the API segment grew by approximately 28.19% and the exports by 29.13%.

Around 50% of the overall Year-on-Year growth in the API segment was due to volume growth. Formulation segment revenues grew by around 89.49% on Year-on-Year basis on the account of high export growth. In formulation division 50% of the sales came from exports in June 2020 quarter. For the period ended June 2020 revenues from the API segment can be broadly classified into following therapeutic categories.

The antibiotic therapeutic category contributed to around 46%, Antiprotozoal around 16%, anti-inflammatory around 13%, anti-diabetic around 10%, anti-fungal around 5% and specialty and intermediate categories put together another 5%. Rest can be classified as other categories. As compared to last financial year of 2019-20 anti-inflammatory segment has increased from 10% to 13%. Mainly on the account of higher sales of existing products and recently expanded Diclofenac derivatives facility.

Consolidated EBITDA for the quarter ended June 2020 is Rs. 135.23 crores up by 146.89% and consolidated profit after tax for the quarter ended June 2020 is Rs. 85.45 crores, up by 280.63% on a Year-on-Year basis. Consolidated EBITDA margin improved to 24.83% despite challenges faced during COVID-19 lockdown. The company was able to maintain good operational efficiency which along with good realization in selling prices lead to increased gross margins.

Debt-to-equity ratio of the company reduced further down to 0.55 as of June 2020 on a consolidated basis. Company has already scaled up its anti-diabetic and anti-inflammatory capacity and it will give impetus to revenue growth in FY2021. This would be further supported by good growth in formulation exports.

Additional CAPEX is planned for introducing new products in anti-diabetic category towards the end of FY2021. As the lockdown is easing out project work should pick up pace in coming quarters. Also company positively looks forward towards the recently announced production linked incentive scheme by the government.

Now we would like to open up for Q&A session and take questions from the participants.

Moderator: Thank you. Ladies and gentlemen, we will now begin the question-answer session. We take the first question from the line of Aditya Khemka from DSP Mutual Fund. Please go ahead.

Aditya Khemka: Adhish, first question on the top-line growth. Our performance, Aarti Drugs' performance in fourth quarter of FY20 and first quarter FY21 has been pretty good on the top-line growth; most of it seems to be driven by formulations ramping up. When you consider your first quarter FY21 formulations' revenue, could you add a little more color as to what is the capacity utilization now in formulations and how do you see the trajectory going forward for this segment of your business?

Adhish Patil: Yes, so formulation capacity utilization at the moment is about 75% to 80%, having said that in our formulation division, we also focus on getting our products manufactured from various LL sites,. So we are getting our production made from about 5 to 6 approved facilities, where we do have spare capacities and there we are ramping up our next line of products.

So in terms of the growth, our focus in formulations is on addition of newer products through our R&D and opening up more and more markets because the export market, which is the higher profitable market, we are expecting many approvals in the next coming quarters and coming year for this high link that we had initiated two years back. So the major growth will be propelled through the increase in exports and higher utilization in our third party sites.

Aditya Khemka: In your third party sites when you get these products manufactured, the value addition that you as Aarti Drugs do is the R&D of the dossier and the registration?

Adhish Patil: Correct.

- Aditya Khemka:** And when you sell it to these countries you obviously sell it to business partners there because you do not have a ground presence in any of the export countries, so it is your business partner who is selling the product to the local population, correct?
- Adhish Patil:** That is true, so in most countries we sell it through our business partners, but we do directly or indirectly get involved in the marketing of the products in many of the countries. And going forward we also have, in Aarti Drugs has its own subsidiary in Latin America as Pinnacle, Chile, so going forward the formulation business would also in Latin America be done more as a frontend company rather than a P2P company.
- Aditya Khemka:** So my question on Pinnacle was actually my second question. So in Pinnacle could you explain the business modular little more to me, do we have a field force, is it branded products that we are participating in or is it that we are participating in the institutional business in Latin America, what segment are we targeting?
- Adhish Patil:** We are basically targeting institutional as well as the private market. Currently our higher portion of the sales is coming from the institutional markets. I could say the split would be about between 60% to 65% from the institutions and then from the private retail market.
- In the retail market, again there are different models in different countries. In some countries, we have strategy of just selling it to the end consumer that is the distributor and then the distributor promotes those products whereas in some of the markets, we are deeply involved in marketing the product ourselves and the distributor is just taking care of the logistics and the pure storing and distribution.
- Aditya Khemka:** My last question for this is on the revenue that we did in fourth quarter and there were some shipments I think in the fourth quarter con call we had indicated, which got deferred because of the lockdown in the last 10 days of March. Could you guys call out the top-line impact of recognizing that revenue in the first quarter and therefore how much is the new normalized Rs. 45 crores that we have done in the first quarter, how much is the normalized revenue excluding the booking of sales, which were supposed to be booked in March?
- Adhish Patil:** We can say about the revenue that we missed in March and that got pushed to this quarter would be about anywhere between Rs. 5 crores to Rs. 6 crores.
- Aditya Khemka:** Rs. 5 crores to Rs. 6 crores, so that is not a big number.
- Moderator:** Thank you. We take the next question from the line of Sudhir Bheda from Right Time Consultancy. Please go ahead.
- Sudhir Bheda:** Sir, just wanted to know, just while listening to your TV interview in the morning and you said EBITDA could be ranging between 18% to 20%, while in Q1 you have shown the EBITDA of 24%. Does it mean that EBITDA will fall going forward? That is the first question and second sir, just can you throw light on API industry as a whole in view of China's problem vis-à-vis

world which is looking at the China with some problematic manner, so can you elaborate on that?

Adhish Patil:

Yes. What we said was right now our consolidated EBITDA margin is between 24% to 25%, so we will close the entire year around 18% to 20% is what we feel because right now the margins are very good and there is shortage of product in the market. Chinese competition has increased the prices of lot of API products and traditionally since last four to five years, we have introduced lot of products, which are import substitute. So most important competition for Aarti Drugs Limited is Chinese company, so that is one of the main reasons why we showed very good margins in June quarter.

So, going forward as this pandemic eases out, we do not know how the situation will pan up. The thing is as of now the margins are similar, but we do not know how the margins will look like in December or March because right now the situation is very dynamic. It is very difficult to predict a long-term margin forecast based on today's conditions. So that is why we gave a conservative estimate of we might still close the entire year around 18% to 20% of EBITDA margins and historically before COVID we always used to project around 15.5% to 16%. So there we do see some improvement no doubt about that, but 24% might be little high on a very long-term basis.

As far as your second question is concerned, the China prospective and how it will affect API industry. So it is somewhat related to this first question that earlier in March month we thought that this COVID-19 impact seems to be very temporary one, but then as the situation panned out, lot of countries there is growing discontent against the Chinese suppliers and they want to add more and more suppliers and want to favor some other countries for that matter. So because of which that can be a kind of structural thing, which would lead to higher demand for Indian API going forward.

And so the thing is API industry and the chemical industry in general will do quite well is what we feel going forward in three to five years and also Indian government is taking lot of urgent steps to make sure that this particular industry thrives going forward and India's dependency on China is reduced.

Moderator:

Thank you. Next question is from the line of Sunil Kothari from Unique Asset Management. Please go ahead.

Sunil Kothari:

My question is also related to some previous questions. Broadly I wanted to understand is you said our top-line growth out of this API growth, what you said I think what I understood is that 50% is because of volume and 50% is because of price. So largely this is because of non-supply from China or customers are ready to outsource from other source other than China and that is the reason they are paying a little higher price also. So broadly if you can talk little bit more about volume growth and volume opportunity?

Adhish Patil: One of the main reasons, which hindered volume growth in June quarter was also because of the fact that in April month we were not able to run the factories efficiently and also some of the stock in last few days of March month at that time there was complete shutdown. So initially we were able to tell using whatever opening inventors we had, we liquidated those, but we did feel some shortage at the production side also.

So that is why the volume growth was not that handsome, which we expect. In fact going forward what we expect better volume growth, but as far as the price growth is concerned, most importantly the Chinese companies have increased their prices also. Across the board, even the competition in our industries those have also increased the selling price, so it is not that just we have increased the selling prices, but the market itself has gone up for these APIs and that is why we were enjoying better margin in June quarter.

Sunil Kothari: Sir, currently we hear about China has again came back to full production, they are supplying very easily and prices also have fallen, so any update from your side on these things? Because normally industry what happens when price of raw materials or API fall, they again go back to original suppliers, so how you see this current temporary situation and what is your view for little medium to long term?

Adhish Patil: In median term, as of today the situation is more or less similar, but in longer term for any business for that matter, very high margins are not sustainable for any business, there is always a new entry possibility. But for API industry as of today there are quite a few entry barrier, one of them being the products which we manufacture is in top 12 to 13 products, we are leading manufactures in India in almost all of them barring 1 and in 3 to 4 products, we are leading manufactures globally. So no big company will entry into these products because they know the position of Aarti Drugs is already consolidated as far as market is concerned.

The small companies might come in, but again the CAPEX involved in putting up API plants is now very high and plus the fact that government have made sure that pollution norms are made, regulatory norms are made or else they are giving closure notices to most of the companies that will also serve as one of the entry barrier in API industry. So these factors will definitely help us sustain some of the increase in margins, but then definitely right now the situation the pricing might get little relaxed, but still what we feel is going forward the margins will be higher than the historical margins.

Moderator: Thank you. We take the next question from the line of Vivek from GS Investment. Please go ahead.

Vivek: Just wanted to know more about the sustainability of these numbers because this is especially in view of very little exports going out to US and USFDA approval is still pending. How could be that a trigger for us in the future?

Adhish Patil: Vivek, sustainability means of the ROW market we just spoke about in the last question. Regarding your question about US market, so our current FDA status is such that fortunately

we were able to contact FDA just a month back in June quarter in fact. They have given us clear requirement what they expect from us and now we are working in much focused direction.

One of the most important thing, which FDA has demanded from us is that whatever work we have done so far for compliance they want external certification of that work from some recognized third party auditor, so we have already given them the action plan, but we will be giving them the current status by August end and then one or two months later we will be giving them the certification of the implementation of CAPA from the third party. And then I think FDA will trigger the audit because already couple of ANDAs which have referred our DMA for active in US, so that should speed up our approval process as far as USFDA is concerned.

As far as Europe is concerned, we already have good approvals for three of our big products for Europe market and we are definitely very positive towards increasing our sales in Europe market in near term so that will definitely a big add on as far as EBITDA margins are concerned.

Vivek:

That is very good sir and will you just highlight few of the differentiator for our company in the segment which we are operating in beside the API and formulation, we also have a presence in specialty chemical segment where our parent group Aarti is very, very focused on and they have adhered to the policy of substituting China made products and that is turning out to be very successful for us also I think?

Adhish Patil:

Correct. In fact, Aarti Drugs has also been following that strategy of input substitutes right since I would say 2013-2014, so we have expanded lot of products gone for backward integration as well to compete against China and we had successfully done so in the past especially in Floxacins you can say. China was very dominant in Floxacin historically.

But then as of today we are proud to say many of the products like Ciprofloxacin will be joined Cipro and Enro together, then Norfloxacin possibly we will be largest in the world, even enrofloxacin as of now in India there is virtually no one other than Aarti and ofloxacin also we must have become largest in the world. Levofloxacin again slightly laggard, but I think we will pick up pace in that product also.

So import substitution has always been one of our strategy and it is doing well and it will do even better because now government has also become very active to promote the import substitute, so that will further benefit us.

Moderator:

Thank you. We take the next question from the line of Dhwanil Desai from Turtle Capital. Please go ahead.

Dhwanil Desai:

Few questions. First one is on margin trajectory. I think you have indicated that post COVID structurally things could have improved for API industry in general and for us and then

whatever 15.5% to 16% margins that we were looking at would probably move towards 18% kind of a range. Is that because Chinese import will come down or is that because people will have preference for Indian APIs, how does that dynamic work? Can you throw some light on that?

Adhish Patil:

Yes. Recently what we had observed that even in China it is like the Chinese company get lot of export incentive from their government. Another confirming evidence of that is when we sell our product to China we get very high selling prices as compared to what China exports to outside world.

So the thing is even Chinese companies in general they are also increasing their prices because they also wants to become more profitable and going forward as most of the companies are getting listed in China also, earlier margins were not big concern for that, they used to operate even at 3% to 4% level. So that way we feel that the Chinese prices will also remain high, that is what we feel.

The thing is even in some of the specialty and intermediate products, we have also seen a trend where Chinese people they want to partner with Indian people for setting up plants in India. So which also tells us that structurally that Indian industry as far as chemicals and APIs are pertinent intermediates, it should do well in the future also.

Dhwanil Desai:

My second question is that you had alluded to possibility of some longer-term arrangement for some of the product which are existing or new with our customers. Is there any concrete proposal on table or more of any conversation on that time going in or is that because typically that is not a structure on which API market works. So is anything changing to warrant any change in the structure of the business?

Adhish Patil:

One thing what we have seen that many of the companies are pushing towards the longer-term contracts so that is one thing where we can see that they want to tie up with Indian companies from long-term point of view.

Dhwanil Desai:

Longer term means you mean it is like instead of every consignment basis may be two, three, six months or it is more of a year kind of?

Adhish Patil:

They typically go for supply agreement in terms of quantity and then they try to fix the price based on some parameters. It is something like that. Because we also do not want to fix price because market is dynamic right, so what if the prices of raw material goes up, so that will be difficult.

Dhwanil Desai:

Another two questions. One is on the formulation side. I think we have done a very good job on the formulation type 2. Our top-line has shown very smart growth, gross margins have improved significantly on the formulation side. Can you elaborate on what are the reasons, how should we think about the sustainable numbers? I remember we were targeting around Rs.

200 crores plus and I think at this run rate that looks very achievable. If you can throw light on that, that would be very helpful.

Adhish Patil: Yes, Vishwa will answer your question.

Vishwa Savla: In the formulation part the major growth like Adhish said this was being propelled because of the growth in exports, so earlier whilst we were mainly only a domestic company, we now have almost 50% of our revenue coming in from exports and that is what has been triggering our growth since last couple of quarters. Going forward also we still have a lot of registrations that are expected to get approved in the next few quarters and we are also opening up more and more international markets both in the ROW, semi regulated front as well as a few expected approvals in the next one, one-and-a-half year in the regulated markets.

So in terms of our growth in formulation definitely we have foreseeing increase in exports and that will lead to in growth in top-line as well as improvement in the gross margins. Having said that in this current quarter our both the revenues and gross margins are higher because we had good institutional orders. So the higher proportion of them was shift in this quarter, while we do not expect the same numbers to continue for every quarter but in terms of a top-line we can expect between Rs. 250 crores to Rs. 280 crores on this formulation front this year.

Dhwanil Desai: The last one is on the specialty chemical project, the greenfield one that we were planning. Any updates on that, that could helpful?

Adhish Patil: Specialty projects we were doing trying to find out innovative process with R&D work was on and we got a good success in that, but because of the COVID thing that project got delayed, what we wanted to start. So as soon as this gets done, we will be starting that mostly in our land parcels in Gujarat, there we will start up this project for specialty chemicals, but it is looking very prominent for us.

Dhwanil Desai: Okay. Which will come on stream in FY23 something like that?

Adhish Patil: Yes, towards the end of FY22, at least something should come up, some of the products will come up we believe.

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

Abdul Puranwala: Sir, just on the domestic growth on the API side, I just wanted to understand, over year and the customer side would this be again on a particular quantity uptake basis or these would be certain long-term contracts, which we would have signed with the domestic plants and so similar performance could be seen in the rest of the year?

Adhish Patil: So Abdul, for domestic clients as far as volumes are concerned in fact we feel that June quarter was quite nominal since we expect much better volumes than what we did in June quarter going forward from domestic market and that is mainly because of the acceptability of our

products with most of the clients. It is a continuous process so we try to keep on getting more and more approvals from more formulation player so that they are registered as their approved supplier and then can start lifting commercial quantities, so we are doing good in most of the products. The volume growth should be much better than in June quarter going forward is what we feel.

Abdul Puranwala:

Sure sir. Next question on this the government scheme, which has been announced of close to Rs. 10,000 crores. How are CAPEX plans have been aligned because as what I get the sense is it is only going to be offered for companies who do new greenfield expansion plants? So any CAPEX outlay what we have, any number we have in our mind currently what we are going to go for the scheme?

Adhish Patil:

Yes, PLI scheme is one thing, but other than PLI also irrespective of that we had quite a few projects in mind. So for the next three years we have a clear-cut visibility of projects requiring CAPEX of almost around Rs. 300 crores to Rs. 400 crores that visibility is there. Many of them would be a backward integration projects also where we will be actively consuming most of the products and in some of them it will be like for outside sale as well and because of the PLI scheme also there are lot of products in the PLI scheme where there is lot of synergy with Aarti Drugs, couple of intermediate products are of great interest to us, then even 2 to 3 APIs are there for which we will be doing investments.

Now the policy will become clearer, definitely there was one session today, which I was not able to attend unfortunately, but I will get the minutes of those. The thing is even though it is greenfield, but you can have brownfield kind of expansion is what we learnt from one of the big four companies. So they told us that greenfield is defined as where we need to do a CAPEX, for API I believe it was around Rs. 20 crores, for intermediate it was around Rs. 50 crores per project kind of a thing. So if you do that kind of a CAPEX to put a fresh production line may be in your existing location, but a new production line something like that is what they mean.

Abdul Puranwala:

Just one final question from the bookkeeping side, so when I see the standalone numbers and I compare with the console, so I believe that the subsidiaries in this quarter would have done remarkably well. So would that largely because of good uptake in formulations or some clarity on that one would be very helpful.

Adhish Patil:

So the thing is our formulation 100% subsidiary Pinnacle has done really well on year on year basis in June quarter. Mainly on the accounts of very good exports and in fact we have very good pending orders lined up for that company.

Moderator:

Thank you. We take the next question from the line of Saravanan Viswanathan from Unifi Capital. Please go ahead.

- Saravanan Viswanathan:** In the last con call we had mentioned about the land bank that we have and that could be used for future expansion and so at what stage would we go in for the environmental clearance because it could take time, right?
- Adhish Patil:** For that we are already gone ahead for few products and for few we are going right now, so that process we have already started trying to take approval.
- Harit Shah:** Adhish, for one project we already got environment clearance.
- Saravanan Viswanathan:** Which you can start?
- Harit Shah:** Specialty chemicals which we are proposing, we already got environment clearance for that product. It is a big site, so we have taken approval for one project, but we will do multiple projects there, so one product we wanted to do on specialty chemicals for that environment clearance we already received.
- Saravanan Viswanathan:** So that allows you to start the work now itself if everything else is available, man and material?
- Harit Shah:** Yes.
- Saravanan Viswanathan:** The production linked incentive scheme or even other government thrust on APIs, do you think it will also propel smaller players to put up more capacities? Would it also increase a domestic competition for larger players like us?
- Harit Shah:** Here the issue is for intermediates we need minimum investment of Rs. 50 crores other than land and for API we need Rs. 20 crores, so how small players can put in Rs. 20 crores on each product, it is very difficult.
- Saravanan Viswanathan:** My colleague Anand has a question.
- Anand:** This growth for Pinnacle in export market, is this sustainable? Do you see these orders that you have got and you have currently some backlog, is this more a structural change client which should give us business every quarter now? Can you elaborate a bit on that?
- Adhish Patil:** Yes, Vishwa will answer your question.
- Vishwa Savla:** So like we said for this coming quarter we already have lot of open orders and going forward like I said this current quarter was exceptionally high because of some pending from the March quarter and additional orders for this quarter. But we do feel that with our growing registrations and growing markets that growth is sustainable, most of our clients are long-term clients, so that business will continue and the growth will be propelled by addition of new markets and new products.

- Anand:** Okay and in terms of our current capacity, how are we placed? Would we need CAPEX in formulations in this year or next year and if yes how much are we planning?
- Vishwa Savla:** Currently our utilization is somewhere between 70% to 80% in formulations, however, we do have several third party sites where we are also getting our production manufacture and loan license where we have kind of exclusive tie up with those manufacturers and we have increased our capacities at those sites as well as our increase in revenue will come from improvement in the product mix. So the growth in exports will be a product that are higher value both in terms of revenues and in terms of gross margins as compared to the lower value products that we were making for the domestic market.
- So in the current year, we are not expecting any major CAPEX. Our major investments are going into the R&D and the marketing side to develop good products and do the bio equivalents studies in several products, but no immediate plan on major CAPEX investment.
- Anand:** Once you obtain USFDA approval or clearance, how will the capacity allocation, will there be a change? Can you take us through that?
- Adhish Patil:** Right now the E-22 Tarapur Plant is under USFDA alert, the utilization is that way is quite less, less than say around 50% or so and we are now manufacturing for other clients also from that plant. Some in Europe where we are getting better margin, but then as US business grows definitely we will be replacing the plant with the US business because ultimately we want to maximize the profits.
- Overall potential for that current production line would be anywhere between Rs. 70 crores to Rs. 100 crores, but then we have another adjoining block area for expanding and putting up of fresh production line within the same API number. So the scope of expansion is there in that facility.
- Moderator:** Thank you. We take the next question from the line of Aditya Khemka from DSP Mutual Fund. Please go ahead.
- Aditya Khemka:** First of all just to check your previous comment, so the total revenue both API and formulation put together that got spilled over from March to June quarter is Rs. 5 crores, correct?
- Adhish Patil:** What Vishwa must have told for formulation that Rs. 5 crores and plus API say another Rs. 10 crores you can say approximately, little here and there.
- Aditya Khemka:** Rs. 15 crores in overall number, that is fine. On the API side in the split that you gave, antibiotics being the highest contributor to our revenue still, could you talk a bit about how much is our dependency on raw materials from China for our antibiotic franchise and how are you guys looking at that dependency going forward?
- Adhish Patil:** In most of the floxacins we are quite backward integrated, but it does not mean that you are totally insulated. The thing is for many of the imported raw materials, we still have options in

domestic market also, but at a slightly higher price. So it is the case of absolute stoppage of supply, but then in that case our selling prices would also go up and that will mitigate the risk of rising input cost.

However, there are few products where we are already doing R&D, we already developed technology. We are thinking of putting up plants and also have to get tie ups done with some of the other chemical companies to put up those plants by giving them the technology, so that process is continuously on. So I do not feel more than 20% of the raw materials is there where we are critically dependent where we do not have any other source.

Aditya Khemka: So more specifically just to understand your comment if you take an example of Metformin, so the intermediate called DCDA, for DCDA are you looking to like produce DCDA in house or would you continue to procure it from China?

Adhish Patil: DCDA frankly speaking it has a wide application, not just Metformin, so that is why the risk involved in procuring DCDA is not much that way, however, in past also we have been looking into the technology to manufacture DCDA, so that is always there, which we always try to keep the processes ready even though we do not have immediate plan to put up the plant, but we will develop the process and keep so that in case of such events happen, at least we have some head start to go ahead with.

Aditya Khemka: You said that some of these intermediates cost more in India than they do when you procure from China? What is the price difference on an average Adhish between the product from India and China?

Adhish Patil: Harit might be able to answer that.

Harit Shah: It would be in the rise of 5% to 10% depending on the products, many times now they have started matching the price because Chinese intermediate prices have started going up, so more and more products we are trying to source from India now even if cost is high by 2% or 3% or 4%. But some products which is very high beyond 10% we still import from China, but I think many Indian companies are now started making some chemicals which are predominantly produced by Chinese company, so we have lot of opportunities in India to produce that product actually.

Aditya Khemka: Right, this 5% to 10% average difference in price, what was this price difference let us say two or three years back between the Chinese product and the Indian product?

Harit Shah: That time Indian producers were not producing, so now once people have started producing we do not mind paying some premium also for Indian companies basically. Some of the products we were not producing earlier.

Aditya Khemka: Right and the reason you are willing to pay a premium is because you have the ability to pass on that to your customer?

- Harit Shah:** Yes, and also the supply chain is an issue. Chinese supply in fact are very erratic.
- Aditya Khemka:** Yes, that was my question. Is the supply chain from China still being erratic, are consignments still coming with delays and getting stuck at various ports or is the supply chain contract is now?
- Harit Shah:** True, actually only three or four days we had some issues stacking our imports, but things are normal now. We do not have any issue. You will not believe in April month, we have cleared 100 imported containers in spite of so much COVID situation, transporters were not available and we were able to manage that scene in April also.
- Aditya Khemka:** Fantastic. Just one last question. We spoke about some greenfield and some brownfield efforts on our side and getting environmental clearances. From an ease of doing business prospective, are these processors now taking longer, shorter versus two years back or how has the timeline changed if at all it has changed?
- Harit Shah:** Actually government is very responsive nowadays particularly API, Department of Pharmaceutical is very responsive. They have come out with PLI scheming at COVID times that was biggest plus point. They were talking three-four years back, but even Prime Minister's office has pushed them to come out with a policy even in COVID time.
- There are lot of positive developments that are there from government side at least now for API. They want to reduce dependency from China basically. The whole purpose of government is not depend on China.
- Aditya Khemka:** Right. One last question I had. On the USFDA side, Adhish what is the status now? Where are we and if you want to comment what is your expectation on when the audit could happen?
- Adhish Patil:** Yes, unfortunately there was some communication which we missed out from FDA because of change in personnel and they had communicated only through hardcopy. It is a very unfortunate event, but now when we asked them again, we reached out to various different people from FDA and one of them replied to us, so they gave us communication about what are their clear expectations from us.
- One of the main expectation is they want whatever changes or compliance we have put in, in our facility for all the points which they have observed in past three audits, so there they want compliance certificate from an external auditor. So that is one of the most important thing, which they want and once we provide them that, then they are willing to inspect the facility. That might be like physical inspection or that might also be remote inspection what they are doing with few other companies right now.
- Aditya Khemka:** Right and how much time and money would it cost you to send them this external report from the consultant?

Adhish Patil: I do not think that total cost should go beyond Rs 50 lakhs or Rs. 1 crore, it will not go beyond that all-inclusive I am saying, certification plus compliance and everything.

Aditya Khemka: And time?

Adhish Patil: We have taken two months' time for them, this August end we will be replying them with all the current status of all the points from last three audits where we are. In some of those points there will be external certification might be already present in some of them. In some of them, there still might be time. We have taken another two months after August, that is September and October for someone possibly from Ex-FDA inspector something like that to come and visit the facility.

And give the compliance report so that if someone is Ex FDA then they will trust them more from certification point of view and then they will be willing to do the audit. Either that might be a paper audit or that might be a physical audit that we also do not know. Because if we do it from a reputed person, the third party, I do not know how FDA will go forward with it.

Moderator: Thank you. We take the next question from the line of Sajal Kapoor from Unseen Risk Advisor. Please go ahead.

Sajal Kapoor: Just a couple of questions I have. One is what is the target ROC and the gross block asset turn for this incremental CAPEX that you spoke about for Rs. 300 crores to Rs. 400 crores over the next three years, so what is the target ROC and the gross block asset turn? That is one part and this Indian Government supported PLI scheme will that be diluting our target ROC?

Adhish Patil: Target ROC it is difficult for me to answer for all of them, but target asset turn what we look forward to ranges from three to five times. might be it depends on product to product, but that the thing is that is based on what market price is going on for that product as of now, but many of the products, which we are launching are also for captive consumption. So in a way you know that may not reflect in top line, but definitely it will impact the bottom line.

Sajal Kapoor: So Adhish, when we talk to other competitors in India, other API companies, they usually talk about asset turns in the range of 1.75 may be 2, rarely we get to know this asset turns upwards of 2.5 and you mentioned 3 to 5. So what is it that we are doing? Is it our chemistry is very different, and we are able to squeeze better asset turns? Can you just add some more colors?

Adhish Patil: Frankly speaking, it is like we are there in this business since last 36 years, so technologically our company is very sound and that is one of the only reasons why we are able to survive through commodity kind of products. We cannot call them commodities anymore, but earlier people used to call drugs like commodity products. Now with a stringent regulations and more stringent impurity profile those days are gone away.

But the thing is yes our manufacturing operations are quite efficient, usually we put very high capacities, which in turn help us to increase the asset turn because the kind of CAPEX it does

not go up that exponentially when you double the capacity. It is not in the liner fashion. So when you put a bigger capacities, the asset turns are much better.

Sajal Kapoor: Understood and that is better in case of brownfield right? I think that is what you are alluding?

Adhish Patil: Perfect. In case of brownfield it is fantastic, the asset turns are very good.

Sajal Kapoor: And may be if I could just press you on that ROC part. So currently we are hovering in the region of 20% and with the increasing volume and this brownfield capacity expansion, is it unreasonable to expect an upwards of 20% to 23% ROC in midterm?

Adhish Patil: In midterm may not be unreasonable, but then in longer term if at all the selling price is correct, but still 20% to 25% is something which we can always expect.

Sajal Kapoor: And that is a very healthy range, 20% to 25% in API in our kind of business is very healthy. I was just trying to get some sort of range, so that kind of answers to my first question and secondly if you could just quickly confirm the operating cash flow we had in Q1 please? Thank you. I can see the operating profit right, so I just wanted to get the equivalent on the cash flow side?

Adhish Patil: The thing is the net operating working capital slightly went up around Rs. 100 crores, so other than that everything is available for operating cash flow.

Sajal Kapoor: So Rs. 100 crores adjusting after the working capital is receivable and the inventory?

Adhish Patil: No, Rs. 100 crores will adjust the working capital what I am saying.

Moderator: Thank you. We take the next question from the line of Karan Rathod from AUM Advisors. Please go ahead.

Karan Rathod: Sir, if you can just quantify for us the total benefits that accrued to Aarti from the anti-dumping duty that has been imposed by the Indian Government on the full range of the Ofloxacin antibiotics just to give us a sense on how of this profitability is at risk if that duty were to be removed? Just an approximate sort of an estimate would also do.

Harit Shah: Actually we have only one product as of now which has anti-dumping duty called Ofloxacin which is we are going to apply for renewal which is going off by next year March. Recently we got anti-dumping duty on Ciprofloxacin there is a provisional duty. So only we have two products but still anti-dumping duty on Ciprofloxacin is not notified. So there is no dumping duty as of now. But we have only one product where we have anti-dumping duty as of now, Ofloxacin.

Karan Rathod: So how much would that be? I mean how much would be the sales side be?

- Harit Shah:** So it is about \$3 to \$4 a kilo depending on the producers. So depending on each manufacturers different, different duty is there up to \$6.
- Karan Rathod:** The other question was the overall on your capacity utilization if you could tell us which are current sort of capacity plus the CAPEX that you have planned in FY21 what would be the total potential turnover at peak utilization from these facilities? From your existing capacity and the expansion that you have putting up this year how much will be the total potential turnover at full utilization?
- Adhish Patil:** See from standalone point of view I think Rs. 2,200 crores, Rs. 2,300 crores is now the selling prices have gone up but from with the earlier selling prices it was around Rs. 2,000 crores to Rs. 2,200 crores for standalone company and plus Pinnacle would be extra.
- Karan Rathod:** And how much would Pinnacle be at peak utilization?
- Adhish Patil:** I guess this year itself we will try to achieve anywhere near Rs. 300 crores kind of mark.
- Karan Rathod:** So would you say about Rs. 2,000 crores, Rs. 2,200 crores at standalone and Rs. 300 crores at Pinnacle level would be peak utilization of all your capacities?
- Adhish Patil:** You can say so but then the Pinnacle model is such that capacity utilization is not that important for in the Pinnacle case because there we are holding IP so we can get it done outsourced, we can outsource also, the manufacturing part a little bit. So there is no limit as far as Pinnacle is concerned. As far as API is concerned you are right around Rs. 2,200 crores is but we need to check that frankly speaking because now the prices are high. So that might have gone up right now.
- Moderator:** Thank you. We take the next question from the line of Umang Shah from Asian Market Securities. Please go ahead.
- Umang Shah:** My questions have been answered.
- Moderator:** Thank you. We take the next question from the line of Anurag Roonwal from Moneybee. Please go ahead.
- Anurag Roonwal:** I actually wanted more clarity on this anti-dumping duty which is coming on Ciprofloxacin. So I understand nowadays provisional. Do not you think the final order is expected? This is first part. Secondly I wanted to understand what is the kind of improvement in margins that we would be having because of this duty? And what is the kind of share that Ciprofloxacin has? If you could just give a ballpark sort of number on that total API sales?
- Harit Shah:** Normally this is a provisional duty and Finance Ministry will normally notify in two months most probably. So we are expecting notification to come in effect from somewhere in August. Further they are probably because of COVID the Chinese companies must have not given all

the data and all those. Although there is a WTO norms so which might take another four to five months to get final duty basically.

So there is an injury government has accepted the department has accepted there is an injury. So how much is injury unless they get data from Chinese companies they will not be able to process further. So it might take another four to five months from today. What is your second question?

Anurag Roonwal: I wanted to understand what is the kind of impact that it would have on the margins for this product and whether this product is a....

Harit Shah: Typically we used to keep our price in such a way that we do not allow Chinese producer to sell more products here. And then there is anti-dumping duty of about \$2.2 average. So we expect at least that much margin to go up. And plus we have additional, India was importing about 300 tons of Ciprofloxacin for domestic consumption. So that market we can capture basically by competing with Chinese companies. So that is an additional advantage.

Anurag Roonwal: And is the product is a significant part of our API sales or is that?

Harit Shah: Yes, we are the largest producer of Ciprofloxacin in India and we are the second largest in the world. So that is one of the major product.

Anurag Roonwal: So it will be around 20%, 22% of our total sales?

Harit Shah: 22% of our sales.

Anurag Roonwal: Of our API sales?

Harit Shah: Yes.

Moderator: Thank you. We take the last question from the line of Raj Rishi, an individual investor. Please go ahead.

Raj Rishi: I just wanted your comments on this particular leading industrialist from your sector, pharma sector, she said that after this geopolitical issue COVID etcetera and the supply chain shift which is expected to happen, the API industry will prosper because the issue will not just be cost. It would also be a shift to diversify the risk. Could you just comment on that? Do you agree with this? It is not just going to be cost as a criterion?

Harit Shah: Yes, what is happening is most of you see even in India whatever we sell, many of our API sales in India ultimately they export cognizant to the world basically. So no one prefers to buy, everybody would like to prefer Indian source than Chinese source due to regulation, availability of documents and now more and more countries are becoming more regulated types. Like in African countries are now asking for more and more documents which many

companies in China cannot offer, many companies, not all but many companies. So more and more shift is there in India towards Indian formulation companies.

Raj Rishi: You as an entrepreneur since 2019 whatever optimism you had about your sector and say today end July 2020 based on certain issues which have happened, COVID, geopolitical whatever. So what is your level of optimism we as investors, traders etcetera we rightly hopefully likely we are much more optimistic about your sector. Are you more optimistic or your optimism level is similar to what it was?

Harit Shah: We are very optimistic. Like last six months our optimism level has gone up like anything.

Raj Rishi: And that is because of this COVID etcetera?

Harit Shah: Before COVID also, For last three years you can see that the chemical industry in China there more but due to pollution norms there is a shift going on. So it is not. Last three years all Indian chemical industries are doing good. Now the turn of API because it is like total shift towards pharmaceutical companies.

Raj Rishi: And do you expect any further measure from the government to boost the API sector or you think you as a player would be satisfied with what they have given this sector?

Harit Shah: I think the government cannot do more basically than what they have done because they identify 54 products which are more China depended and out of that 26 is fermentation and 24 is of chemicals business. So, government side due to government own limitations they have tried their best.

Raj Rishi: And like do you have land available for further CAPEX or you will have to buy land?

Harit Shah: Yes. We have an existing land parcel in Gujarat, and we have one land parcel in Maharashtra also in Tarapur or somewhere. And recently we acquired one land parcel. We are already in the final stage of getting the land.

Raj Rishi: Your present land availability would take care of your CAPEX for how many years as of now or your projections whatever it is?

Harit Shah: Whatever we are talking in next three years we do not need any further new land unless we get ready plot here and there then we might bag.

Raj Rishi: I did not get your, what did you say, last?

Harit Shah: Three years.

Raj Rishi: Do you have any CAPEX fundraising plan as of now?

Adhish Patil: Fundraising plans in the sense of equity funding you are asking?

- Raj Rishi:** Yes, both equity or otherwise, debt?
- Adhish Patil:** See our internal accruals will be very strong as going forward. So that should take care of most of your funding of CAPEX. However, even as far as debt is concerned right we are getting very good interest rates. We are getting anywhere between 7.3% to 7.5% for as long as six years, long term loan and again post Tax will be even lesser so this cost of debt is even lesser. So source of funding is not a big issue for us.
- Raj Rishi:** Any equity raising plans because the financial markets are willing to give you at a good valuation so do you not think it will be prudent to raise funds when the market is willing to give you at a good valuation?
- Adhish Patil:** Right so if whatever shortfall we might face apart from after sufficing from the internal accruals we will evaluate whether the equity will be cheaper or the debt will be cheaper at that point of time. So we will evaluate that.
- Raj Rishi:** Okay. So what is the ballpark debt equity?
- Harit Shah:** We want to maintain the debt equity ratio also basically, yes.
- Raj Rishi:** So what sort of debt equity ratio would you work with say what sort of range?
- Adhish Patil:** See right now it is 0.55%. Historically if you go back 5 to 6 years we were always in 1.4%, 1.5%. But then now with this kind of profitability and it is not like it has happened overnight. Continuously each quarter if you see the debt to equity ratio kept on reducing. So it is very comfortable right now even 0.75% is very, very comfortable debt-to-equity ratio for us in that way.
- Raj Rishi:** But you would not like to go above 0.75% as of now?
- Adhish Patil:** Yes, we will try to avoid it. And that is also even if it goes or towards 0.75% immediately when the project cash flow start kicking in again it will be reduced. Like it will be a temporary thing.
- Moderator:** Thank you. Well, ladies and gentlemen, that was the last question for today. I would now like to hand the conference over to the management for closing comments. Please go ahead.
- Adhish Patil:** We thank you all. Thank you, Cyndrella for hosting the conference and thank you all the analysts for coming in and asking questions. It is always good to interact with you so that we are also on our toes and keep performing for coming quarters.
- Moderator:** Thank you. On behalf of Centrum Broking Limited, we conclude today's conference. Thank you for joining. You may now disconnect your lines.