Aarti Drugs Limited
Manufacturers of : Bulk Drugs & Chemicals

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July 28, 2023

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 Q1 FY24 Earning Conference Call

Please find attached herewith transcript of Q1 FY24 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: 2023.07.28 20:33:38 +05'30'

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

"Aarti Drugs Limited

Q1 FY '24 Earnings Conference Call"

July 24, 2023

Disclaimer: E&OE - This transcript is edited for factual errors. In case of discrepancy, the audio recordings uploaded on the stock exchange on 24th July, 2023 will prevail

Management: Mr. Adhish Patil – Chief Operating Officer & Chief Financial Officer, Aarti Drugs Limited
Mr. Harshit M. Savla – Joint Managing Director – Aarti Drugs Limited
Mr. Harit Shah – Whole-Time Director, Aarti Drugs Limited
Mr. Vishwa Savla – Managing Director, Pinnacle Life Science Private Limited
Strategic Growth Advisors, Investor Relations Advisors – Aarti Drugs Limited

Moderator: Ladies and gentlemen, good day and welcome to Aarti Drugs Limited Q1 FY '24 Earnings Conference Call. This conference call may contain forward-looking statements about the company, which are based on the beliefs, opinions and expectations of the company as on 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 this conference call, please signal an Moderator: by pressing star, then zero on a touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Adhish Patil, Chief Operating Officer and CFO of Aarti Drugs Limited. Thank you, and over to you, sir.

Adhish Patil: Thank you. Good morning, everyone. Hope everyone is doing well. On behalf of Aarti Drugs Limited, I extend a warm welcome to everyone joining us today to discuss our financial results for quarter ended 30th June 2023. On this call, we are joined by Mr. Harshit Savla, Joint Managing Director; Mr. Harit Shah, Whole Time Director of Aarti Drugs Limited; Mr. Vishwa Savla, Managing Director, Pinnacle Life Science Private Limited; and SGA, our Investor Relations Advisor.

I hope everyone had an opportunity to go through the financial results, press release and investor presentation, which we have uploaded on the stock exchange and on the company's website. The company reported a decent performance in Q1 FY '24, with a top line growth of 6.3% Y-o-Y on a consolidated basis.

Revenue stood at INR661.7 crores as against INR622.2 crores. EBITDA stood at INR84.7 crores as against INR67.4 crores in Q1 FY '23, a growth of 26%. EBITDA margin are at 12.8%. The company's performance improved on a year-on-year based on normalization in the input cost, the effective working capital utilization. On a year-on-year basis, EBITDA margins improved by around 200 basis points driven by improved capacity utilization.

The cost of raw material stabilizing, our gross margins have improved in the current quarter and will continue to improve further going ahead. PAT stood at INR48 crores as against INR34.8 crores in Q1 FY '23, a growth of 38%. PAT margins stood at 7.3%.

Our entry into the dermatology product segment and the implementation of backward integration in the second half of FY '24 along with stable input costs are expected to accelerate margin expansion. As a result, upcoming quarters are likely to witness improved margins on a sequential basis.

Coming to standalone performance for the quarter. The revenue for Q1 FY '24 stood at INR591.6 crores as against INR551.2 crores, a growth of 7.3% Y-o-Y.

The standalone business contributed around 86% to the consolidated revenue for the quarter. Around 68% of this revenues came from the domestic market and around 32% from the export market for Q1 FY '24. Domestic revenue grew by around 13.6% while exports de-grew by around 4% year-on-year for Q1 FY '24.

The API business experienced significant growth with a volume increase of around 18%, primarily fueled by the rising demand in the domestic market. Within the API business, the antibiotic therapeutic category contributed around 48%, anti-diabetic around 13%, anti-protozoal around 17%, anti-inflammatory around 11%, antifungal around 7% and the rest contributed around 4% to the total API sales for Q1 FY '24. However, API export face challenges with quarter as some export geographies experienced USD shortages leading to slower growth in those geographies.

In Q1 FY '24, the formulation business segment recorded around of INR89.9 crores, constituting approximately 14% of the total company revenue. The majority of the revenue accounting for 67% was attributed to export sales, which has seen a remarkable increase compared with the previous year.

The company's strategic focus on increasing regulatory filings has led to this significant boost in export revenue. As a result, it is expected that the proportion of sales through exports will continue to grow in the future, particularly in the semi-regulated and regulated markets. To further strengthen its market position, the company is committed to investing in new product launches, regulatory filing and capacity enhancement.

Now the Specialty Chemicals business experienced a year-on-year impact in Q1 FY '24, primarily due to the absence of a couple of campaign-based products during the period. The specialty chemical industry is currently confronting challenges on a global scale as China has reopened and is flooding the international markets with the products at lower prices. Despite this reopen, the demand within China itself is not sufficient, prompting them to export at cheaper rates. Moreover, the chemical sector is experiencing a decline in prices to reduce demand from Latin America, Europe and U.S.

As a result of these factors, export numbers for Indian pharmaceutical companies have faced pressure in Q1 FY '24, which has also impacted us to some extent. However, we have formulated action plans to mitigate this impact and are determined to see every possible opportunity to faster growth in this sector.

The capital expenditure incurred during Q1 FY '24 amounted to INR48 crores and it is projected that the total capex for the entire fiscal year will be between INR250 crores to INR350 crores. Notably, all of the capex plans including Gujarat Saykha capex and Tarapur capex on dermatology and Specialty Chemicals, both of which belong to high-margin accretive category are scheduled to be completed within this fiscal year.

The implementation of these projects is expected to lead to improved growth prospects for the company moving forward. Commercial operations for these projects are set to come in Q3 FY '24.

On 21st July 2023, the Board of Directors of the company has approved the buyback of 6,65,000 fully paid-up equity shares, representing up to 0.72% of the total number of outstanding equity shares of the company at a price of INR900 per equity share as a part of our distribution policy, payable in cash for an aggregate amount of up to INR59.85 crores on a proportionate basis through the tender offer. This shall bring total distribution of around INR280 crores over the last 8 years in the form of either dividend or share buyback growth inclusive of taxes.

Throughout this year, our primary focus is on augmenting our capabilities and improving our product offering to consistently meet the ever-changing demands of our clients. Despite taking immediate challenges, we are steadfast in our approach, investing them and maintaining an optimistic outlook on the potential within both the API and non-API industry. We anticipate a robust growth trajectory at all segments in coming terms. This growth is expected to be fueled by the successful execution of existing projects and the increased utilization of our current capacities.

In the formulation business, we foresee a consistent rate of growth in exports. With this, we can now begin with the question-and-answer session. Thank you.

Moderator: Thank you very much sir. We have the first question from the line of Rashmi Shetty from Dolat Capital. Please go ahead.

Rashmi Shetty: Adhish, could you comment on your metformin capacity, which in last quarter, you said that will be adding up new capacities? And also, can you explain on Gliptin whether the utilization has picked up in this quarter? Or it is still not contributing significantly?

Adhish Patil: Yes. So regarding metformin, yes, we finished the expansion plan. Our plan was to scale up, increase the capacity further in Q1 that increased further around 30% to around say, 1415 tons per month kind of a capacity. So we have completed that expansion. So because of this expansion, our facility was shut for some period and that also led to the decrease in the volumes sold in metformin in Q1 FY '24. So now that is complete and we expect metformin sales to grow, henceforth.

As far as Gliptins are concerned, right now for the said quarter, there is not much increase in the sales of Gliptins but could discuss about it for the future, I'll ask Harit to comment on the same.

Harit Shah: Yes. We are consolidating 2 Gliptins sales slowly and steadily. It will take some more time to take a significant leadership position but we expect our cost to cover backward integration and making some basic stage will help us to improve our market share slowly and steadily.

Rashmi Shetty: Sir, what is holding back, is it that the demand is slowing down and that is why you could not supply or the orders are less? What exactly is happening in this Q1?

Harit Shah: See, what has happened is when product goes off, I think, at least 30 20 players wanted to market the same product at the same time. So ultimately, it will bottle down to 3 to 4 players over 1 or 2 years or 3 years. It will take more time to consolidate basically. Those players who have gone backward integration and those who are product players who have cost efficiency has been ultimately take more market share.

Rashmi Shetty: Got it, sir. And anything with the execution of this major capex, which we're expecting that by H1 FY '24 will be complete? What kind of revenue growth are we seeing in FY '24, '25 that we should build in? And EBITDA margin, what are you looking for FY '24 and '25?

Adhish Patil: Yes. So as far as EBITDA margins are concerned, so right now, we were around 12.8% to 13%. We expect to close this current financial year with a quarterly EBITDA of at least 14.5%, 15%. We still hope for it. And going forward, it should improve with the newer capacities coming in.

As far as the revenues are concerned, so we feel like in the current year, around 10%, we'll try to achieve, though it will be challenging because there has been negative rate variances as far as sales are concerned because as you know, that the input prices have gone down and so are the selling prices.

So that will put a downward pressure but in spite of that, because of good volume growth, we are expecting at least to touch 10% growth in the current financial year. And then the addition of new capacity, the total potential will be around, say, around INR1,000 crores to INR1,200 crores from both the project but you can safely say around 30-odd percent utilization, 30%-40% utilization in the FY '25.

Rashmi Shetty: Okay. So is it safe to say that in FY '25, we should grow in the range of 13%- 14% on revenue front and probably EBITDA margin from the 15% level we can reach to around 15%- 17%?

Adhish Patil: See, we select a 15% to 16% because when we launch those products itself, obviously, there will be some price loss because of existing players as well. So the first year might be like similar, but not too high, but we definitely hope that going forward, we should be able to increase our margins with this taking projects.

Moderator: The next question is from the line of Gagan Thareja from ASK Investment Managers.

Gagan Thareja: Sir, the first question is on the API business. You indicated that volume growth in API has been 18%, if I heard it correctly. Is this in aggregate? And if that is the case, what has been the impact on pricing year-on-year for you on API? Is it up, by how much is it lower?

Adhish Patil: Okay. Yes. So that was on the aggregate basis what I told you and majorly that entire volume growth is because of the domestic market, frankly speaking. And as far as the rate is concerned, so around year-on-year, almost on an aggregate basis, there is minus 8% to 9% de-growth as far as the rate is concerned.

Gagan Thareja: Okay. But I mean if one were to compare it with fourth quarter of previous year, 4Q FY '23, how are the prices for your API has moved?

Adhish Patil: So if you compare with the March quarter on a sequential basis, the prices have gone down by around 3% to 3.5%. And at the same time, what we can see on the purchase side, also around 2% to 2.5% prices have gone down.

Gagan Thareja: Okay. And input prices compared to a year ago, how much have they dropped, for example, down from 1Q?

Adhish Patil: So if we compare June versus June quarters, on June '22 and June '23 quarters, then the input prices on an aggregate basis have gone down by 15% to 16%.

Gagan Thareja: 15% to 16%. So I mean would it be a case that given there's a 15% to 16% drop in input prices? The output prices will also drop some more to achieve parity between the drop in input prices. So would it be a case that there could be some pressure on margins because of price pressure on finished API products going ahead?

Adhish Patil: Okay. So ideally lower input prices mean better margin, ideally, so it will not put pressure. Only probably is when there is a sudden movement in a short period that for the one quarter, sometimes there might be inventory losses. But as of now, we are not seeing further volatility though we have seen around say, 2% to 2.5% drop in the purchase price as compared to March quarter in June '23 or March '23 quarter. Still, what we saw that from the month of May until the month of June, the prices were stable.

Gagan Thareja: In 1Q of this year, were you carrying some high cost input inventory and therefore, the blended price that you have probably is higher than the spot prices? Is that also okay?

Adhish Patil: Yes, sometimes our input booking is for the longer tenure. So in some particular cases, it can happen anytime.

Gagan Thareja: So for you getting into the consecutive quarter with this 2Q, your input prices will fall further down if the market prices of the KSMs and solvents remain stable because you had some high cost inventory?

Adhish Patil: So now the input prices are not falling down, though there are specific cases like in a few categories for few particular raw materials like antibiotic and anti-diabetic. We have seen dropping prices, but there are rising prices other few raw materials. On an aggregate basis, there is no drop.

Gagan Thareja: Yes, there is no drop in the market prices, but would your average inventory cost in this quarter because it was blended with some high cost for you sequentially also that should highly reduce? Is that correct? Because, sequentially, let's say, from 1Q to 2Q because you'll be buying your overall buying price of your raw materials will drop down further, not because the market prices have dropped, but because your inventory cost, which was higher in 1Q will reduce in 2Q?

Adhish Patil: Yes. We definitely expect that to happen on a sequential basis. I believe the margin should improve because the effect will be removed.

Gagan Thareja: But are your customers coming in and negotiating for lower API prices now?

Adhish Patil: See, mainly there's some market process. It is not more than negotiation being to do with the market process and how efficient you are with respect to your competitors? So that will affect the margin.

Gagan Thareja: Because I think the whole of last year, not only you, but most API companies are on the view that input prices had gone up, utility and power costs have gone up, and you were unable to pass it on to your customers given the environment in the market. For formulations, it was weak. Everybody talked about very high inventory in the channel and therefore, primary sales are impacted. If that is the case and you were unable to pass on, logically speaking, you then have not raised your API prices to formulators.

So there's no argument for formulators to come back to you and say reduce prices now but I would presume it all depends on what the final volume growth for formulations is and what's the excess capacity or shortage of capacity in the system mainly in the product. So just trying to understand your assessment pertaining to your products of this environment.

Adhish Patil: Yes. So frankly speaking the prices stay where they are right now. We expect the margins should improve, except for export market, where we can see some challenges in terms of volume offtake because of the dollar shortages. Other than that, for domestic market, we expect things should be better, much better than last year.

Gagan Thareja: And how was utility in part has been for you this quarter year-on-year basis, how much will they end up to?

Adhish Patil: Utilization?

Gagan Thareja: No, no. I'm talking about power cost..

Adhish Patil: Okay. Okay. Utility.

Gagan Thareja: Yes.

Adhish Patil: Yes. I assume power cost first increase, hike in the power rate was done in this Q1 FY '23, last June. Then in the second half of last financial year, again there was a slight increase towards the end of the financial year but as far as the coal prices are concerned, coal prices have come off, which almost, it was around some INR11, it has come down to INR8.5 and we expect it to further go down.

Gagan Thareja: Okay. So that will also benefit you to a certain degree and so would lower freight costs. Is that also...

Adhish Patil: Yes, freight costs have already gone down. I believe some not listed in since December '22 quarters, that improvement started.

Gagan Thareja: And for the capex that you have, INR250 crores, how much would be debt funded?

Adhish Patil: Yes. So right now, from a standalone basis we are having a long-term rate of around INR225 crores. So we are planning to raise, though there will be repayments. So on a rough basis, around INR100 crores, we might add up long-term loan at the end of this year.

Gagan Thareja: But overall, gross rate would be how much as of today, consolidated?

Adhish Patil: Overall consolidated would be at INR590 crores.

Gagan Thareja: INR590 crores.

Adhish Patil: All put together what thing we have to do.

Gagan Thareja: And in terms of working capital, last year was also difficult for, I presume all companies, but have things improved? And should one assume that this year?

Adhish Patil: We have slightly improved, though we are working out a plan to further reduce the inventory. We can reduce the inventory days because historically, we have seen that pre-COVID there was no problem in terms of supply of raw materials, no uncertainty was there. And in those times, our inventory days were slightly lower on the RM and WIP side. So we will definitely try to work on in those areas.

Moderator: The next question is from the line of Maulik from Anand Rathi.

Maulik: So my question was that on a sequential basis, the prices are not reduced significantly, but our revenue is down 11% mainly and the API revenue is down by approximately 17% sequentially. So has the volume declined on a sequential basis? Can you please throw some light on it?

Adhish Patil: Yes. So the volume has declined on a sequential basis if we compared with respect to March '23 quarters. And mainly, as you said, it is mainly distribute the export and spec chem segment. In fact, in last March, Q4 are typically always the big quarter for us. But having said that, in the last March quarter, there was a heavy buying on the antibiotic space, especially in domestic market. And because of that, slightly the sales were lower in March and coupled with the fact that the spec chem segment in the export market didn't do well in Q1 of FY '24.

Maulik: Okay. Okay. And one more, so in the last one of the questions you said, that INR1,000 crores to INR1,200 crores of additional revenue expected from 2 projects. So which 2 projects are you mentioning? Where those metformin and dermatology or can you please elaborate?

Adhish Patil: There was one backward integration and spec chem greenfield project and second one was the dermatology greenfield project. And plus, there is one brownfield expansion as well, which is going to be completed in August in the next month.

Maulik: Okay. Brownfield expansionalso. Okay. Okay.

Moderator: The next question is from the line of Rahul Jain: from Credence Wealth.

Rahul Jain: Congratulations team for a good set of numbers. So Adhish, just to understand, you mentioned in a previous participant question about that we will still achieve about 10% value growth for FY '24 in spite of the current environment. So just to understand, can you talk about 10% value growth for the current year? You are assuming that the prices are at the current levels for the remaining part of the year. Based on that, the assumption is of 10% value growth.

Adhish Patil: Yes, correct.

Rahul Jain: And the assumption will be that you will continue to grow high teens volume growth.

Adhish Patil: Correct. Correct.

Rahul Jain: Sure. And with regards to the capex, if you could just share details in terms of the growth capex in the current year to get over and next year in terms of the schedule at what juncture, what kind of growth capex gets over in the current year and the next year, the time line? And apart from that, what is the maintenance and the backward integration capex?

Adhish Patil: Okay. So typically, the maintenance capex, maintenance plus, I would say, debottlenecking capex both together for our company typically is in the range of INR40 crores to INR50 crores per annum, which also takes care of the higher regulatory, GMP requirements, debottlenecking and the maintenance taken, all put together, INR40 crores to INR50 crores. Rest is all put for the bigger project like big capacity like enhancement. So in the current year, we plan to complete around anywhere between INR250 crores to INR350 crores or INR320 crores, we are targeting to complete inclusive of the maintenance capex.

And next year, probably, we have a plan of further expanding anti-diabetic segment. So that capex might come up next year. And plus we have another project on paper, which is you can say same side chain product for our dermatology products. So if that work well, there will be another growth though it will be a new product launch, but it will be done in the existing slot. So it won't be completely greenfield but sort of mix of brownfield and greenfield, which you can come in next year.

Rahul Jain: Okay. So you said current year, you will complete around INR250 crores-INR300 crores, including INR50 crores-INR60 crores of maintenance capex. So rest will be growth capex, right?

Adhish Patil: Correct. Correct.

Rahul Jain: And next year, the quantum of capex would amount to how much, excluding the INR50 crores- INR60 crores of maintenance and regulatory capex?

Adhish Patil: So if both the projects start, that is we can talk about anti-diabetic and another is side chain products. If both the capex start, then we haven't worked out yet, but around INR100 crores to INR200 crores capex might be there for the next financial year.

Rahul Jain: This is over and above INR50 crores-INR60 crores, correct?

Adhish Patil: No, including of that.

Rahul Jain: Including. Okay. Sure. And just coming to the FY '25 growth in terms of revenue. So typically, considering again today's prices, what kind of revenue growth and the capex plan getting completed as per your schedules as we see today? What kind of value growth we can see for FY '25?

Adhish Patil: **For FY**'25, so as you said, it will depend on the utilization of the greenfield projects, which you're putting this year. Total potential would be around INR1,000 crores to INR1,200 crores from those 2 greenfield projects and we expect to see around 30% to 35% utilization in the first Q, that is FY '25 in terms on utilization.

Rahul Jain: And lastly, on the margin front, you mentioned that of considering the present situation and the prices of most of the overall aggregate products getting stabilized, both on the input and our product side, we expect the margins to have a sequential improvement. And then end current year or quarter 4, you will see around 14%/15% margins. Is that another.....?

Adhish Patil: Yes. Yes. Correct.

Moderator: The next question is from the line of Dhaval Shah from Girik Capital.

Dhaval Shah: Yes. My question is very broad based. So given we've seen this Chinese behaviour in the market and dumping it, the prices came down. Now there is also an element of freight cost, which was built into it when the prices went up. So when the scenario was a regular pre-COVID, so compared to that time and today's realization for your key products, what is the price difference?

Adhish Patil: It will depend. But I know about one on top most product for this country, which is around 19% to 20% of our standalone revenues. For that product, it is, in fact, it's exactly the same just before COVID and now between INR1,800 to INR1,900 range.

Dhaval Shah: Okay, which is a product?

Adhish Patil: Ciprofloxacin.

Dhaval Shah: Ciprofloxacin. Okay. Okay. So prices are back to the pre-COVID level.

Adhish Patil: But then as I said, I recollect first this product, but others I have to check.

Dhaval Shah: Yes. Yes. Yes. But for this, you are saying that the prices are back. Okay. And how about the raw materials for these products? I mean basically, your per ton margin, are that also back? Or how is that?

Adhish Patil: Let's say -- the thing is one some cases, we are making those margins. But the problem is there are other factors like the inventory in pipeline. So considering that, then picture scenario looks a little different. But if we compare just the sales orders and the POs what we are raising today, it seems like the margins are back. Only problem is because all the FIFO techniques, inventory calculation is down FIFO basis, so that is impacting the overall margins of the company when we report it quarter-on-quarter basis. But otherwise, it seems like the margins should be back.

Dhaval Shah: Okay. And the capex plan, if I understand, we have not changed anything. Whatever we had thought about before, we've kept the same instead of this certain volatile times, which has come and hit the industry. Am I correct?

Adhish Patil: So yes. So what has happened as far as the capex was concerned, one capex got delayed because we constantly take on changing the process to further improve before even launching the project, before that, we were constantly doing R&D. So the process part has changed. That is the only change as far as the original plan was concerned. And one anti-diabetic expansion, which we planned 2,000 tons per month. That, only that, it has got delayed and probably we'll do it next year.

Dhaval Shah: Okay. Okay. Got it. And in last quarter, I did not attend the call, anything on this paracetamol? Have we stabilized it? What is it on the PAP front ?

Adhish Patil: Paracetamol is the group company, not direct.

Dhaval Shah: Correct. Correct. The para-chemicals, right, something.

Adhish Patil: Right.

Dhaval Shah: Yes. So that have we got the quality, required quality for PAP?

Adhish Patil: Harit, can you comment on this?

Harit Shah: No. We are not aware of it because it is not belong to Aarti Drugs, that product. So we are not aware of the quality part exactly. Yes.

Adhish Patil: Thank you.

Moderator: The next question is from the line of Harsh from Marcellus Investments.

Harsh: So sir, in the product pipeline presentation, I saw that now we are entering into some of the methylamine based products. So can you elaborate on that? I could see that 2 have already been developed and 6 that are in the pipeline.

Adhish Patil: Yes, it's mainly to do with the backward integration and some few side chain products might be that might be selling outside.

Harsh: Okay. And this backward integration is for metformin, is it?

Adhish Patil: Yes.

Harsh: Okay. But sir, in metformin, I recall that there is only one of the products, which is used. However, we are entering into a broad host of products, which are methylamine based, that is something which is not adding up actually.

Adhish Patil: No. So there are side chain products. Maybe you manufacture the product. Automatically, you get a certain proportion you get other products. So that is why it means we will be selling those products.

Harsh: Okay. Okay. But any plans to enter in much more deeper manner in this space?

Adhish Patil: I hope now not much. As of now, not much. It's mainly to do with the backward integration.

Moderator: The next question is from the line of V.P. Rajesh from Banyan Capital Advisors.

V.P. Rajesh: I'm just trying to understand if you are seeing any pricing pressure from China in any of your major products because what we're hearing is some of the chemical industry related products, there has been excess supply that will be coming from China. So I was just curious, how does that impact our business?

Adhish Patil: Yes. So as far as the API is concerned, it's not impacting very severely. It is spec chem space where we have seen a little drop in demand from a few of the inventories. So that needs solution. But otherwise, it's more of an indirect impact to us, not the direct impact.

V.P. Rajesh: And it's reducing your raw material prices, right?

Adhish Patil: Yes, the raw material, overall, the trend is downward.

V.P. Rajesh: Like earlier, you were talking about 16% decline in your RM prices. So can one assume that, that particular excess supply is starting to somehow flow into your RM cost in directly?

Adhish Patil: One, as for your RMs are concern, this is around 60% to 70% of RM, almost 70%. They are directly or indirectly linked to crude. So last year, because of this Russia-Ukraine thing, the crude has gone up very sharply. And if I recall it correctly, in the month of September from the crude corrected. And after that, we had seen this downward trend in a lot of raw material prices, which are linked to crude directly or indirectly. So that is one major thing to impact and probably opening up a few more suppliers that can supply more than the demand, that can also impact. But mainly, I think we attribute it to the fall in the crude prices.

V.P. Rajesh: I see. And just a related question, how much of your RM are sourcing within India versus Europe versus China? Any color on that, please?

Adhish Patil: Yes. So it's almost half-half and almost half of. And we do have the option to buy locally also few of the raw material. But because we've seen bulk, so we can put entire containers as well, so it does have to be cheaper for us. And hence, we are referring to both.

V.P. Rajesh: So half is coming within India and half is coming from China, you're saying?

Adhish Patil: Approximately, yes.

V.P. Rajesh: I'm sorry, I didn't hear that.

Adhish Patil: Yes, half is India and half is import.

V.P. Rajesh: Imported mainly from China or is there other source?

Adhish Patil: Around 80% to 90% of the import is from China.

V.P. Rajesh: Okay. So let's say, 40% from China and 10% from rest of the country and 50% locally, right? That's sort of the mix.

Adhish Patil: Okay.

Moderator: Thank you. The next question is from the line of Aniket Kulkarni from BMSPL Capital.

Aniket Kulkarni: Yes. So I had just a question regarding to the RM prices, especially pertaining to crude. So can you give a color on what is the risk to the API business if we see any upturn in crude prices and let's say they go back to those 100-odd levels, which they had gone up before. And since China has opened up and the supply bottlenecks have eased out, should the impact of any higher crude prices from here be a significant risk to the business?

Adhish Patil: Okay, yes. So as you correctly pointed out, there are 2 factors, late number of suppliers and plus the crude prices also going up. So that had caused a sudden uptick in the raw material prices linked to crude last year. And whenever there is a sharp increase in prices in a very short -- then definitely, it impacts demand in shorter term. It impacts margins in shorter term because as everyone has asked previously also that there are the absolute profit per kg or per ton for API manufacturing whether that remains same. And our answer to that was always that in shorter term, yes.

But if it stays for a longer term, say, a couple of years, then definitely, the margins will be revised. The per ton absolute profit will also be revised for the 8 years. So to answer your question, if it goes up sharply in shorter run, it can definitely impact the margins, but in the longer run, the business has been stabilized at a new norm, I would say.

Moderator: The next question is from the line of Rahil Shah from Crown Capital.

Rahil Shah: Just asking the point on the specialty chemicals side. You mentioned in your remarks, the demand has been overall, we believe in that industry and taking some steps to mitigate the impact. So by when can we see this reflecting any contribution overall? So when can we expect this improvement?

Adhish Patil: One is that we'll be tapping more and more customers. We can clearly see the challenges we are facing in certain products, but we're trying to overcome them. One is expansion. One is related to transit, which will take care of that. Then other is that our contract manufacturing businesses because of serious labour shortages in the quarter of June. We were not able to deliver the certain material, which will be now start showing in the coming months.

So as far as the spec chem is concerned, those are the steps we are taking. As far as exports in general for the API is concerned, we are always trying to see whether we can do businesses in alternate services like AED or euros with certain geographies. Those kind of things like fine because we don't want to sell in the conditions that receivables should be addressed. So that is why we went through. We can see the demand. We can see the inquiries, but problem is we are reluctant to dispatch until the situation gets good.

Rahil Shah: Okay, so that like tentatively by when will you see improvement in general?

Adhish Patil: So, the macro factors, it is difficult, but as far as the spec chem is concern, Q2 there's just slightly return, hopefully than Q1. And then Q3 should be even better because we will have additional product also for Q3.

Rahil Shah: Okay. Okay. And just sorry to repeat it, touching the point on the EBITDA margin. Correct me if I'm wrong. You said you will improve quarter by quarter and then you will end the year at in the range of 14% to 15%. Am I right?

Adhish Patil: Correct. Correct.

Moderator: The next question is from the line of Zain from Dolat Capital.

Zain: Just have one question. Adhish?

Adhish Patil: Yes.

Zain: Yes. So I want to know about each of the plant update, the one which was under input alert. What are the updates of regarding that?

Adhish Patil: Yes. So regarding that, last response, we had changed in September and then they had come back to us in the month of February of 2023. And we have given some additional information there from us, and we had prepared by the end of March 2023. And meanwhile, we were waiting to get our EU GMP inspection by the end of last calendar year '22. And we are expecting the GMP certificate, which we just received from European authorities for the same facility. So now we are adapting a later just along with this EU GMP certificate to expedite the process of inspection.

Zain: Okay. And you also mentioned in last quarter that the high cost RM inventory was not completely utilized in Q4. So in Q1, is it completely utilized?

Adhish Patil: Sort of it, yes. Because if we compare June quarter with March quarter, the RM decline is just 2% to 2.5%. And that to last 2 months of the June quarter is May and June, we do not see a decline. So probably, but having said that, on an aggregate basis, it is completely utilized. But in few cases, there are drops, but then that will always be there. But on an aggregate basis, the higher cost inventory looks to be utilized.

Moderator: The next question is from the line of Gagan Thareja from ASK Investment Management.

Gagan Thareja: The 2 greenfield capacities that you talked off, two questions there. One, what's the breakeven utilization for you on these capacities? And when you give your margin guidance, would it include the initial negative impact as these capacities come on stream with their full cost and over a period of time to achieve the utilization.

Adhish Patil: So yes, good on paper, the margins look very high as compared to the company margins and that is a reason why we say that for the first year or so, we expect the margins of the company to be in the single range, 15% to 16%, which are not being too optimistic because we expect some kind of price cuts from the competitors. So yes, transactions, we are trying to take care of that initial price in terms of margin guidance.

And as far as breakeven was concerned, I will get back to you on that because I don't have a exact number at what facility it will breakeven.

Gagan Thareja: Okay. And what time frame do you foresee more optimal utilization in these 2 to happen?

Adhish Patil: Yes. So as I said, we were quite specific you said that 30%/ 35% utilization will be there in the first year. And next year, maybe 60% and then maybe 80% or something like that.

Gagan Thareja: So in the third...

Adhish Patil: It is all projections. Sometimes it gets faster, sometimes it gets slower, especially if it is export oriented, then it's slower. For domestic market, relatively faster.

Gagan Thareja: So is this largely domestic market focused? Or is it...

Adhish Patil: Yes. Yes. Yes. As of now largely domestic.

Gagan Thareja: And which products are these?

Adhish Patil: As you said, these are methylamine and mainly salicylic acid including dermatology segment.

Gagan Thareja: But salicylic acid is a fairly volatile product, right? I mean one of your peer companies in the intermediates has always been indicating that it's a fairly commoditized business. And they see a lot of volatility in prices there.

Adhish Patil: So salicylic acid seems long. Indian manufacturers are not manufacturing them because China has completely taken over the manufacturing of salicylic acid since its launch one decade or so. So most of the companies are now importing that and further manufacturing, converting them into salicylic, which has a vast area of application right from intermediates, pharma intermediates to cosmetics and so on. But we are confident about the process, what we have developed. We have done piloting also. And as of now, the margin is very high, but then we expect some price cuts from China, some reaction from China.

And that is why initially, we are not estimating any exceptionally high margin in that business but in the longer term, we basically expect to get that business from China. Government is also supporting for import subsidization as we've seen in last 2 years. Moreover, we ourselves have certain experience in terms of import subsidization when it comes to floxacin also, O-floxacin, norfloxacin a decade back almost 95% of the Indian consumption was imported. And now it is exactly reversed around 80%-90% is now indigenous we produced, which is imported. So we are fairly confident about this particular product.

Gagan Thareja: So what's the current tonnage market size for salicylic acid in the domestic market? And how much is imported out of that?

Adhish Patil: It's almost completely imported mostly. It would be a little bit 20 to 25 kilotons probably.

Gagan Thareja: Okay. And your process, you feel has better yields? Or are you related to a degree where you believe that you will be able to withstand cost pressure from Chinese supplies and actually be better in terms of pricing?

Adhish Patil: Yes. Yes.

Gagan Thareja: Okay. But there's no policy per se, which might create a duty structure, which will sort of turn the market favorable?

Adhish Patil: There is a scope, but nothing as of number, there is a high chance of that.

Gagan Thareja: But you are not factoring any policy measures in your...

Adhish Patil: No. No. While putting the project, it is purely based on our internal strength. But anything in policy value wise will be an extra limited for me.

Gagan Thareja: All right. And how do the current prices compared to, let's say, long-term average prices of salicylic acid?

Adhish Patil: Harit, would you have answer to this?

Harit Shah: We have seen last 5 years data and more or less, similar trend like based on phenol prices, they have major 2 raw materials phenol and CO2. So more or less, they are in the line of last 5 years, the average price is similar based on phenol, basically.

Gagan Thareja: But I think you did indicate that you believe pricing might normalize over a period of time and current margins are not reflective of sustainable realizing....

Harit Shah: After COVID, prices from China has already started coming down and I think now they are weak to pre-COVID level but margins are concerned.

Gagan Thareja: Yes. So assuming that this is a sustainable average price, are margins on this product are still better than what you currently report at optimal utilization? Obviously, I'm not talking about the start. But when you achieve optimal utilization on salicylic acid, would presuming current input prices remain what they are at what they are? Would your margins be higher than what you today report on a blended basis?

Adhish Patil: Yes. Yes.

Gagan Thareja: By how much would the margin...

Adhish Patil: It will be quite high. But you don't get it, because product wise margin.

Harit Shah: But it will be better than the existing margin.

Gagan Thareja: All right. Lastly, on formulations, I think you've been indicating the exports within the formulation salience of exports will keep on continuously rising. So how does that potent for your growth and for your formulation margins as you move ahead?

Adhish Patil: Vishwa, Would you like to answer this?

Vishwa Savla: Yes, yes, sure. Yes. So, as you rightly mentioned, in formulations, continuously, we are shifting our sales from more domestically led to export, majorly in the emerging markets and gradually into the regulated market sizing also. So as we are extending our product portfolio in exports and also at the same time, opening up more markets, we estimate to see more and more growth over the next quarters in international markets. And we are also doing a brownfield small expansion on our OFD capacities over the next 6 months. So that will also lead to a volume growth.

Gagan Thareja: In terms of margins, would exports have a better margin profile?

Vishwa Savla: Yes, definitely. Because in domestic, we are working more as a CMO, where margins are restricted. So exports have and will continue having a better margin than domestic.

Moderator: Thank you. 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. Over to you.

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

Moderator: Thank you very much, sir. On behalf of Aarti Drugs Limited, that concludes this conference. We thank you for joining us, and you may now disconnect your lines. Thank you.

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