"Granules India Limited Q2 and H1 FY '22 Earnings Conference Call"

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Moderator: Good Morning, Ladies and Gentlemen, Welcome to the Q2 and H1 FY '22 Earnings Conference Call of Granules India Limited. This conference call may contain forward-looking statements about the company, which are based on the belief, 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 participants' 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 '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Dr. Krishna Prasad Chigurupati – Chairman and Managing Director of Granules India Limited. Thank you and over to you, Sir.

Krishna P. Chigurupati: Thank you very much. A very Good Morning, Ladies and Gentlemen. Thank you for very much for attending our Q2 Earnings Call, especially on the weekend. I am glad that we are meeting this time under better condition related to COVID and essentially hope that the worst is over and good times are ahead of us. Though the COVID situation has improved, we are now facing the after wrath of COVID on the economic front especially in relation to pharmaceutical, chemicals, and logistics. Though we are able to overcome the actual crisis, the aftereffects continue to negatively affect all of us for some more time. I am sure all of you are fully aware of the disruptions in supply chain of various chemicals, intermediates, and energy that are happening across the world especially in China. These disruptions have led to huge price increase in various chemicals leading to increased cost of production for our products. The PAP situation that you are all aware of has led to 165% price increase and global acetic acid shortage led to a price increase of 120% in the cost of acetic anhydride. Both these are products are KSMs for paracetamol, which is one of our main products. While our costs have increased drastically, we were not able to pass through our cost to most of our customers in the last quarter. This has been the most challenging quarter in the recent past, but despite the challenges, we have taken various measures to improve cost efficiency to come up with a reasonable performance for Q2.

One of the measures was the voluntary reduction in managerial compensation of the promoters by 40%. Though the performance for Q2 may look subdued, I am personally satisfied with the outcome keeping in mind the extraordinary headwinds we are all facing. Though the challenges will continue for quite some time, I feel the worst is over and that we will see a substantial improvement in our performance in the coming quarters. We are continuously interacting with our customers and we were able to get price increases with most of the B2B customers for Q3. We are making positive progress with the distributors in the US and we see a willingness in them to accept the price increases and we hope to start implementing them shortly. On the logistics front to, though we do not see any freight rate reduction as yet, we see a better availability of container which will help us reduce inventories and increase revenues. Availability of PAP is improving as we had qualified one Indian source and another non- Chinese source. Though the prices have not decreased, we at least have enough products to keep our plant occupied and generate increased revenues.

As we continue to face many challenges in the short term, we will not be able to comply to our guidance for the year. Due to the continual uncertainties, we cannot offer any new guidance either. However, as mentioned earlier, performance has been substantially better than H1. All our initiatives for growth are on track. The new MUPS block starts qualifications in December and validation in the new API capacity built at Unit-5 Vizag have started. Our ANDA, EU dossiers, US DMF and CEP filings are also on schedule.

Based on the current scenario, we are reworking our plans for the proposed Greenfield formulation facility to reduce the capacity and also the cost. We plan to strengthened the savings on setting up facilities for most of our KSMs and reduce our dependency on imports especially from China. There will be a reallocation of CAPEX towards backward integration, but definitely no increase. We are confident of reducing our dependency on China significantly by the end of 2024. I would like to end my speech on a confident note that we see exciting times and a great future ahead.

I now request our CFO – Sandip Neogi, to take you through some of the important financials before we start our Q&A.

Sandip Neogi: Thank you Sir and Good Morning to all of you. Let me now move onto the financials for the Q2 of FY '22:

We are happy with the performance despite the challenges post by various business scenarios in the backdrop of COVID and logistic disruptions resulting in shortage of raw material and lower utilization of capacities especially paracetamol which has been explained in our CMD speech. Coming to the revenue, the second quarter revenue was 888 crores as compared to 858 crores in Q2 of FY '21. Our increased sales of existing products and new launches specially in the finished products vertical has resulted in the increased top line. Revenue share from other molecules has increased to 19% and revenue share of finished products has increased to 57% consistent with our strategy. The sales breakup as per the business verticals and regions are presented in our investors presentation, which is available on the website. Coming to the gross margin, for the quarter, the gross margin contracted from 57.9% in Q2 of FY'21 to 50.9% in Q2 of FY'22 mainly due to reduction in margins of almost all products especially paracetamol due to increase in raw material prices and freight cost, and our short-term inability to pass on the improved price increases to the customers.

Going forward, we will be able to pass on substantial portion of these increases to the customer and therefore, it is slightly that the gross margin percentage will increase. EBITDA and EBITDA margin percentage: EBITDA for the quarter was Rs. 151 crores when compared to Rs. 256 crores in Q2 of FY '21. Apart from the gross margin, we have also seen increase in freight cost by Rs. 20 crores and increase in R&D cost by Rs. 25 crores when compared to Q2 of FY '21. We express that the freight cost should come back to normal around Q4 of FY '22 and for Q3 of FY '22, we are talking to our customers to recover some of these increased costs, which will reflect in our added top line in Q3.

R&D: Our R&D spends for the quarter stood at Rs. 47 crores compared to Rs. 22 crores in the previous year. We are in track with respect to our R&D goals. We are judiciously spending on R&D based on select products and are also among the most efficient companies in terms of R&D cost per project. We will save more in R&D in line with our expansion plan and we will continue to strike a between R&D spend in USA and India. Net debt: Our net debt increased by Rs. 82 crores on account of increase in our short-term borrowing due to significant increase in our inventories because of increased business requirements both on the raw materials and finished goods front. On the raw materials front, we stocked up due to potential COVID disruption and supply issues and non-availability of container has also increased the finished dosage inventory.

Cash-to-cash cycle: Our cash-to-cash cycle increased by 25 days from 117 days in March ’21 to 142 days, mainly on account of planned increased in the inventory holding days, which is up by 25 days. Holding days for Creditors and debtors are in the same range. Planned increased in the inventory as I mentioned is on account of non-availability of containers and raw material requirement that has been stocked up. Other ratios as referred in the earnings’ presentation is also showing a drop in the current quarter. As we are confident that our performance will be substantially better in H2, we expect the ratios to turn better by the end of the year. In order to combat China supply issues, the company needs to build up inventories of significant raw materials and key starting materials. Operating cash flows: Operational cash flow for the quarter stood at Rs.101 crores compared to Rs. 112 crores in Q2 of FY ’21. This was mainly on account of lower operational profit. We had a free cash of Rs. 32 crores while it was Rs. 52 crores in Q2 of FY ’21 after spending Rs. 68 crores of capex for this quarter. Cumulative capex spend for H1 of FY’22 stood at Rs. 231 crores. With this, I would like to open the floor for questions.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Madhusudan Kela from MK Ventures. Please go ahead.

Madhusudan Kela: Good Morning Sir, first of all congratulations to all of you for keeping up the momentum of performance even though the numbers look subdued, I would like to ask two questions, one when you say that the disruptions are likely to continue for long time, what do you mean by long time and when do you think things will get back to normal? Second part of my question is why we all understand the short-term implications of logistics, freight cost, and some raw material price increase, how is it changed the medium term outlook for the company basically I am talking of three to five years, are there any positives in this crisis from the Management perspective?

Krishna P. Chigurupati: First of all Madhu Good Morning to you, the first question is how long will it last? This is a question which is up in the air for anybody and I would not dare give a straight answer to this, but however in my opinion, maybe it should start improving a bit from next fiscal year and over the quarters it should improve drastically and a new normal would be set in terms of pricing. Pricing of raw materials will definitely not go back to old levels and a normal will be set for finished product pricings too. The world has to accept that the costs have gone up and they will have to pay more, so we see this positivity in customers today. Customers who have refused to accept prices in the Q2 have started seeing reality because they have started seeing shortages.

People who had excess inventories come to me especially in the US who are trying to get rid of their inventories and there was no pressure, but right now I see that rates willingness. While the shortages of raw materials may continue, I think the performance of companies may not be in the same line, they would be better as better prices can be realized.

Coming back to the question of medium term, three to five years, we are on track. This year looks like a blip, but under the new normal, I think everything will go on as planned and MUPS block I have mentioned in my speech is getting ready for commercial operations Q4 and also the APIs that we are going to use for all the MUPS products are also getting validated in our API plant at Vizag and that will also give us a lot of comfort. In addition, I have also mentioned in my opening remarks that our FD, Greenfield venture, we are going to slowdown our capacity because we have some decent capacity from the MUPS block not only makes product, it also makes other soluble products and focus while we build the Greenfield venture, it will be possibly half the capacity. We earmarked about 300 crores plus for that, we may end up spending only 150 crores and 150 crores saving plus rather earmarked for APIs will all go into APIs and also backward integration. We are working on various I would not like to expand too much, but I see that by the year ’24, we will not be, forget importing, we will not even be buying intermediates or KSMs. I see that we will be making products everything ourselves in-house and also we are working on differentiated technologies where we may not need these KSMs, so we have already made. We have an example of one of the products where the only supplier of one chemical is in the process is China. We were able to remove that chemical and come out with a process where we do not make that, so there is a lot of work going on. A lot of work had gone on in the last eight years on this front. We were absorbing all the technologies, building various technology platforms, but the time has now come to implement all these and the next few years we will see it is and definitely the medium term outlook is going to be quite bright.

Madhusudan Kela: With this fully backward integrated by 2024, while I do not want a specific number, how will our margin trajectory change Sir? When we are fully backward integrated, is it safe to assume that the margins will improve at least by 200-300 basis points?

Krishna P. Chigurupati: Yes Madhu, the basic thing here is when we are backward integrating, we are not integrating in the traditional process. What we have developed over the last three years or eight years, increased technology with the highest atom efficiency and least carbon footprint. I think I mentioned this briefly in some of the previous calls and as you increase the atom efficiency and reduce wastage as carbon footprint goes down, automatically the cost come down, the usage of materials come down. There will be a very decent improvement in cost. I cannot say what percentage today, but as we commercialize some of these operations, we will start seeing them and like I said the future looks exciting. A slight change in our approach, reducing a little bit focus on finished dosages, but strengthening ourselves by integrating all the way backward does not mean that not importing from China, we buy something from India or we make something from India and intermediate, but the raw material for the intermediate again comes from China, so that does not mean anything, so we are totally going backwards all the way to raw materials, so I think from basic building blocks and from there we are going to work on coming out with final products. It is not only our core products we are working on, but also new products everything will be based on the new technologies and the new approach.

Moderator: Thank you. The next question is from the line of Ashwini Agarwal from Ashmore Investment Management LLP. Please go ahead.

Ashwini Agarwal: Good Morning Sir and congratulations for a reasonable set of numbers in a very, very difficult operating environment and continuing from the question asked by Madhu, I just wanted to get a sense that there are two aspects to the question. One is what happens near term and what happens long term? What I gather is that in the near term what you are suggesting is that the September quarter was probably the bottom in terms of operating performance, operating margin because going ahead, we should start to see some price in escalations coming through to compensate for higher raw material prices and higher freight cost, so that is the medium term question and while I understand you do not want to give a guidance, but if you could at least help us understand the trajectory? Second is that the flavor of capex going ahead has changed with greater focus on backward integration efficiency and carbon footprint versus new product development finished dosages and so on, because from what I understand you are going to keep the capex outlay the same in order to minimize the drag on your cash flows or keep within the cash flows that are being generated by the company, if you could just comment on these two aspects?

Krishna P. Chigurupati: Good Morning Ashwini. Near term I think you have it right, the improvement is not going to come from reduction in prices of raw materials, which could be a positive thing if it happens, but mostly it is going to come from our customers accepting reality. Though we do not see an immediate great benefit in this quarter, but going month-on-month as everybody is facing the same problem, there is no way anybody can supply at these old prices, so there will be an improvement. As we see B2B customers today most of them have accepted that B2C customers especially in US is a challenge, but the good news is that they also have started accepting reality and also the stocks that people had are getting used up and definitely this quarter will see some improvement, in the next quarter we will see some more improvement from our US distributors.

Coming to the capex and outlay, definitely the outlay continues to be the same. We actually had enough money like even if we, we are only saving about Rs.150 crores from the Greenfield facility, but other than that, we have earmarked about 300 plus crores for APIs in the past, so we will be having about Rs. 450 crores to spend on APIs and backward integration and as I repeatedly say and one of my favorite things is carbon footprint. A lot of work is going on and one small block actually, one small product is actually being built right now and we will be going in that more and more of these products.

Ashwini Agarwal: That provides me what I was looking for, one follow-up question I had while raw material prices, shipping costs were kind of challenges during the quarter under review, was there also a destocking at the end of your customers especially in the US that hurt revenue because that is the commentary we are hearing from some other peers in the pharmaceutical industry, so just want to get a sense of what you are seeing?

Priyanka Chigurupati: Could you just explain what you mean by destocking?

Ashwini Agarwal: What we heard is that there were several customers and distributors who had bought a lot of inventory over the last six months anticipating potential disruptions in supply chain, anticipating shortages, anticipating greater demand for base products like paracetamol, Ibuprofen in particular given the pandemic and now as things are returning to normal, the inventory in the system is being run down as a result the primary sales on producers like yourselves are getting impacted a little bit, are you seeing that at all?

Priyanka Chigurupati: Yes, Ashwini, there is actually a mix of what you mentioned in terms of overstocking by the customers as well as overstocking by suppliers, but that said like you actually said, things are getting back to normal in terms of having normal levels of inventory, but that will take some time, we are still not there at that critical point yet. Over the next quarter or two, we will start to see that significant impact on the inventory levels where we should be able to pass on some of our price increases.

Moderator: Thank you. The next question is from the line of Rahul Veera from Abakkus. Please go ahead.

Rahul Veera: Sir, Good Morning, just a quick question from my end, some of the alternate sources to China, for example, if we have empanelled Valiant or probably Sadhana Nitro Chem whose plants of PAP are about to come in a quarter or so, Sir does it require for us to send the revalidation batches in terms of changes of sources of raw material from the client side, is there any process required?

Krishna P. Chigurupati: Let me you ask for details, you said in view of other sources going to manufacture PAP in India like Sadhana and possibly Kutch is there any change in our strategy or what was the question?

Rahul Veera: If we are sourcing it from Sadhana from here once the plant starts, does it require any validation batches or approvals from a customer end?

Krishna P. Chigurupati: Yes, you are right, definitely. First of all, let me answer this question then I will add something else. Any new KSM actually we will also have to file to the USFDA, but then in view of the current circumstances, it could be a quick acceptance, customers and FDA also have to accept and the product we make out of the KSM has to be again validated at our end and the finished product usage also have to validate it themselves, but for our own tablet manufacturing it becomes easier compared to other customers. Coming to Sadhana Nitro Chem, I do not know what is happening with them, they say they are coming online. They announced that rather good news is Kutch has started manufacturing. They are having a few teething issues but they should be, we are also helping them to streamline their processes and they should stabilize pretty quickly.

Rahul Veera: Sadhana I believe is coming through an alternate route like 90% of the PAP is produced by one route and Sadhana is opening for another alternate route, so how do we see the stability of our molecules given the process for Sadhana is little bit different than the normal PAP production?

Krishna P. Chigurupati: The process that Sadhana is going to use is the best process available in the world and there is only one company which makes it today that is Mallinckrodt in the US and nobody else was able to succeed so far. I am not sure few other companies in India, I do not want to name them have tried this, but they have not succeeded, so I do not know what is happening with Sadhana, I wish them all the best if they do that is going to be great, but I would like to add here, we have worked in the last eight years on this technology and we had a pilot plant running for one year producing this day in and day out and we have been very successful in producing right from basic material benzene like the current people use PNCB and PNCB again you need to buy nitric acid, you need to buy chlorine, you need to buy benzene, there are so many other things and then you get Ortho Nitro Chloro Benzene so many issues, but here it is a clean thing starting from benzene, no by-products, we go straight into PAP. We have the process ready and if other people are not able to stabilize their production, it is in our plans to quickly setup a plant. We also have the designs ready; we may be able to set up a plant quickly if others fail, but I wish others successes and we do not have to put our capex into that.

Moderator: Thank you. The next question is from the line of Cyndrella Thomas Carvalho from Centrum Broking limited. Please go ahead.

Cyndrella T. Carvalho: Hi team thanks for taking my question, Sir if you could help us understand in terms of our top three products paracetamol, Ibu, and metformin, how are we seeing the disruption at this level from your raw materials side actually on the PAP side and what is the status, what improvements we have seen and then on the demand side on these top three products, if you could comment and help us understand what is the scenario presently, how has it improved, if you could just give some color on these?

Krishna P. Chigurupati: Good Morning Cyndrella, so let me start with PAP, paracetamol. We just discussed that PAP availability has improved though the cost has not decreased, actually the cost is going up a little bit month on month and acetic anhydrite again which is made from acetic acid and acetic acid made from methanol, there is a global shortage of methanol today, it is not just China and that has impacted acetic anhydrite prices, so which has gone up more than 120%-150% of these products, but looks we are becoming stable now, not any more price increases and acetic acid, there is a slight downward trend, so again like I said prices will not go back to normal. The only way is for us to get some price increases and we are glad that people are accepting this, that is with regard to paracetamol. The good news is we have material to utilize the capacity. Then coming back to metformin, we have increased our metformin capacity drastically and they are also trying to improve our share in the world market. There is a challenge in supply of the DCDA, one of the key raw materials for metformin. Other raw materials are not too bad. DCDA is a challenged but Granules have derisk itself a little bit by buying from the only non-chinese source in Europe at a much, much higher price long before the disruption in China happened. We were very proactive and we said we will pay a higher price, today take a hit rather than suffer a shortage, so that also we have covered though at a higher price that we have supplies. Other products ibuprofen, there seems to be surplus capacity in the world today and that is not at all a problem. We get whatever we need for our formulations, that is going well. There are disruptions in other products, epichlorohydrin for our guaifenesin, prices have gone through the roof and some of the product, one more raw material from China has gone through the roof like I mentioned a little earlier, the raw material that has gone through the roof and we are taking short supply from China, we were able to avoid that and quickly validate our process, so we are working on various fronts and as of today I think we are good on all of our five products and also some of the products that we are validating also we appear to be quite good.

Cyndrella T. Carvalho: This is helpful Sir, just on a industry wide, if the supply is normalized then the prices also should normalize going forward, is that a correct understanding specifically on the raw material side?

Krishna P. Chigurupati: Raw material side again it is not just a question of supplier, supplier also has his own inputs, his own raw materials and with energy situation in China and also let us say methanol, there is going to be a big time lag before new capacities come up. Again in my humble opinion, the world has not really looked at increasing capacities of most of the key materials, key chemicals so that is changing now. It is going to take a while and meanwhile I feel the prices of raw materials will be continuing to be high and energy. The disruption in China in terms of energy again that is a little black box we do not know what exactly is going to happen especially with the winter Olympics coming up in the short term, but even in the long term we just have to see what is going to happen.

Cyndrella T. Carvalho: Sir, just one more thing, if we have to look at the overall scenario on the supply side, when we are looking at the demand side, what is giving us confidence to call it out that gradually at least we should start seeing a better performance and I heard your commentary where you also mentioned that people are ready to accept a higher pricing or we are able to pass on a bit, so in terms of our contracts, how are we placed, where do we see we can forward these pricing and is it led by demand revival or how should we look at it?

Krishna P. Chigurupati: First of all let me separate this, on the B2B side, customers who were trying to get away from contracts in the past and most of them have got away because there is surplus of raw materials are now coming back to us and asking us for long-term contracts and they are negotiating with them based on raw material prices, so we feel B2B customers accepting these contracts, but when it comes to the distributors and the US formulations, it is a different ball game. It does not work like that, fixed contracts do not work in that system, they give you an award, but once they award you the business, if somebody goes lower they have the right to cancel our award and again go for a fresh quotation, a fresh offer, so if you need more details on that I think Priyanka can explain, but I think in short this is the whole gist, but it is all supply and demand. Everybody has a similar price increase, every manufacturer. There is no way one manufacturer can give it a lower price, it is like again keep saying it is a new normal that is going to happen.

Moderator: Thank you. The next question is from the line of Tushar Bohra from MK Ventures. Please go ahead.

Tushar Bohra: Thank you for the opportunity and we appreciate the detailed situation that the Management has explained on the business side and also the performance in light of the issues, Sir couple of points, there is one positive read through on the other molecules where we have seen on a higher revenue this quarter, other molecules have increased their share. I understand there are quite a few initiatives you are looking at beyond the core molecules, if you can just detail out some of these initiatives and the outlook on other molecules? Also, how are you seeing the things on a specific products, any positives particulars?

Krishna P. Chigurupati: We are really trying to get good leadership position in some of the molecules mainly in the present segment in the APIs and of course there are products like in the formulation side products like KCL and dexmethylphenidate, which we make in the US. These are some of the products we think we can keep getting better market share as we go by, but on the API side again coming back one of the products that we see good potential today is Losartan. Losartan I am sure most of you know there have been these azido impurities, which may result in some recalls going forward and everybody has stopped purchases of Losartan and they are looking for Losartan with no azido impurities, so we have a process. Our process does not create this azido impurities, so we have given undertakings to all our customer, most of the new customers that our product does not have these impurities and we have given them samples, we have given them our route of synthesis also, evaluated all patents that we are not infringing on any patents on these things and looks like Losartan is really going to take off for us. We are also integrated backwards in Losartan, so dependency on China for Losartan used to be there. It does not have to be there anymore today, so Losartan is one product that appears quite good in the coming few quarters on short term. Many other products we are working on improving those technologies and capabilities, products like fexofenadine and all. There is a lot of going on, these products also will continue to grow.

Tushar Bohra: Sir, just on the same question, if you can highlight how many new launches we have done this quarter over the last couple of quarters and how the traction is picking up in some of these molecules, can you guide us?

Krishna P. Chigurupati: APIs we have not done any new launches, but FDs Priyanka, you want to say in the US what launches we have made?

Priyanka Chigurupati: In the last quarter Tushar, we did about four launches. We have a decent market share for all the products that we have launched barring maybe one or two smaller products, but the bigger products it is a matter of timing like we have said multiple times, we do not want to crash prices in the market, so we wait for a little bit like some of our biggest products, we are very close to the target market share that we wanted within the first year, so without getting into product specifics, yes most of the products that we have, we have been able to hit decent market shares. Overall, today we have 19 products in the US markets.

Tushar Bohra: My second question is just trying to get a sense on how much of the current performance can be taken as a short term or a transient thing, so we have historically over the last three quarters, we were stabilizing at 57%-58% kind of gross margins, this quarter we are down good 600-700*bps* is it fair to say without seeking your guidance, is it fair to say that once things normalize, our gross margin should inch up back to at least what was the normal earlier if not higher and also the revenue trajectory should continue to move up?

Krishna P. Chigurupati: It should Tushar, we should definitely see improvement in gross margins definitely, no doubt about that but what level will it go to depends on many other factors. Q2 of last year was a very good year in terms of gross margin, whether we will go back to that level may not, but if you want to we can, but the choice we have is to get a bigger market share with a little lesser gross margin or lesser market share with a bigger gross margin, so that is a trade off, so we will take the call based on product by product and definitely gross margins will improve but we cannot say to what level.

Tushar Bohra: Sir, just try to get this clarified slightly better, we had last quarter on a Y-o-Y basis, I think we had also an MEIS impact and if I take the impact from paracetamol which hopefully is clearly a one-off for a couple of quarters, if I were to look at the revenue we did this quarter and hopefully we are able to build a growth on this in subsequent quarters, it would be fair to say that the run rate in profitability that we had achieved on a Y-o-Y basis adjusting for MEIS, we should be able to achieve that level of profitability again in the next year?

Krishna P. Chigurupati: Definitely, we should be able to do that as long as things do not go again out of control, yes, I see visibility on that.

Moderator: Thank you. The next question is from the line of Harshil Patil from Sharekhan. Please go ahead.

Harshil Patil: Good Morning Sir and thanks for the opportunity, most of my questions have been answered, but just need one clarification I think I missed on that comment from your side, so in the US markets we have seen some bit of higher inventory and stocking across channels and simultaneously the second point would be more towards gross margins where we are seeing that some bit of price increase needs to be taken, so Sir would that be a fair assumption to make till the time the stocks or the destocking exercises will not really complete the gross margins would be at similar levels to what we have seen right now in Q2?

Priyanka Chigurupati: I think you are right, I do see that happening. The gross margins will continue to remain at existing level until we start passing on the prices.

Moderator: Thank you. The next question is from the line of Surya Patra from PhillipCapital. Please go ahead.

Surya Patra: Thanks for this opportunity Sir, just on the azido impurities issue which could come up for the Losartan same is the situation even for the metformin I believe so would that be a kind of a concern for us as well and whether any indication or whether any kind of a guidance that we received about it to immune our supply capability of those products going ahead from regulator side?

Krishna P. Chigurupati: I am sorry I did not understand your full question, but let me just start with the first part and you can ask me again, so on the metformin, we have been quite good and we have I think most of the suppliers of metformin, they were one of the few that did not have any issues on nitrosamine impurities except one product which is 750 mg extended release metformin tablet, which was a very small product, so we were very good on that and we continue to be good on metformin, absolutely no issue. Losartan, the azido impurities, the new issue that have come up and for us because we believe in the highest quality, we were already clear of azido impurity and we think that is going to give us a great advantage in the market today. They do not have to do anything to remove that impurity, so that is with regard to these two products.

Surya Patra: Sir, my second question is about the gross margin and the overall margin for company, so what I am seeing that okay if we consider last year was a high wave in terms of revenue and all that, so we have to some extent it is in the similar lines only despite of the challenges and the product mix or the market mix or the category of the product mix all that considered, it has either remained same or improved so despite that there is a kind of soft correction in the gross margin, so is it because of the higher volume of material supplied at an elevated cost means the spread that was witnessed that is one along with the revenue what we are seeing maintained revenue, it is on a driven by higher volumes at a elevated cost level that is why the situation that we are witnessing?

Sandip Neogi: We believe that more than from the Q2 onwards the revenue also will increase and there will be definitely some improvement in the gross margin and we will be able to be consistent with our expenditure run rate also, so therefore, we believe that there will be improvement in our performance both in terms of top line and bottom line, gross margin also will be improved.

Krishna P. Chigurupati: Let me just add to that and also to again because the previous participant was asking the question, it was not very clear to me, gross margins for this year will definitely not go back to old levels. They can only improve from last quarter; quarter-on-quarter we see an improvement, so when I say we will do substantially better, substantially better compared to Q2, but overall like I said the year will not be in line with our guidance, but definitely there will be an improvement quarter-on-quarter and next year we will see that in may sort of get back to a normal growth path.

Surya Patra: Sir, is it large part of the issue is just the cost elevation or it is also on the revenue front there is issues in terms of realization on the broader basis, I am not asking about US specific price increase or something like that, but whether on your realization front for your portfolio also you are seeing some correction?

Krishna P. Chigurupati: The cost is the main issue, cost has gone up and due to that revenues, people are not buying as much as they would like to, it is always a wait and watch. It is just shifting inventories for them also, so when our actual quantities have come down a bit, but because the price escalations, the revenues seem to be the same level of going up, but as demand and as the pickup improves, the revenues will definitely go up a lot, but again to the EBITDA absolute number may come to a decent level, the margins may be slightly less made up by higher volumes.

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

Rashmi: Thanks for the opportunity and Good Morning Management, just want to understand out of your total raw material cost, how much currently we are importing and especially from China?

Krishna P. Chigurupati: From China, the imports are roughly about 35% Rashmi and from the rest of the world from the Europe and other places is going to be another about 43% is the total imports and 35% from China. Out of 35% from China, 27% is only from PAP that is the past, so now with PAP if you can get half of our PAP from India itself and that will just bring it down by 13% straight away.

Rashmi: Like out of 35% if 27% is from PAP, the rest is for the DCDA we are dependent?

Krishna P. Chigurupati: DCDA like I said we are not totally dependent on China, we also have another source, but we are dependent, we do buy from China. We do not have too many products from China, we have substituted most of those other products with domestic vendors or making in-house as well. Two important products are only PAP and DCDA, so PAP I see as one of the in a year or so, PAP can be totally derisked. DCDA will continue to be a little bit of a problem, but that also we are working on some plans.

Rashmi: Sir, what I want to understand is basically this PAP and acetic anhydrite as we said that you will be starting sourcing from the Indian source so that is going to start from third quarter itself or it will take little time?

Krishna P. Chigurupati: PAP we have already started buying from one source in India and one non-Chinese source elsewhere, and Indian source is still stabilizing their production and quarter-on-quarter they will definitely be able to supply more and I see that shortly more than 50% of our requirement would be coming from the Indian source itself. On acetic anhydrite, we always were with an Indian source, very small percentage from Gulf source, otherwise mostly was Indian source, but again Rashmi this is a very complicated world. When I say we are buying from Indian source, the manufacturer of acetic anhydrite imports acetic acid from Gulf or some other players, so that is how it works, luckily not from China.

Rashmi: Second question is related to backward integration which you mentioned that for all your core molecules as well as your key plants for getting into the manufacturing of the KSMs and all, so this could include DCDA also because that would require a huge capital outlay like manufacturing that molecule in our country would require a bigger land parcel clearance from pollution board is also challenging, so is it that you know you would pick that particular products and go for the other molecules? Another thing related to that is that for all these molecules, would you go through PLI scheme and all? What is with the capital outlay total like earlier we planned for Rs. 400 crores this year, Rs. 300 crores in FY ’23 and then coursed by Rs. 200 crores, could the capex remain same that would include this backward integration, or we would require more capex?

Krishna P. Chigurupati: We have enough funds there Rashmi, we provided more than Rs.300 crores for APIs in our CAPEX plan of Rs. 1,000 crores over three years and now we are trying to save Rs. 150 crores from our Greenfield formulation plan, so this will have Rs. 450 crores to spend over the next two-and-a-half years on just KSMs and APIs, so that should be definitely enough.

Rashmi: Sir, regarding the backward integration of these four molecules products especially?

Krishna P. Chigurupati: The DCDA you cannot hit it on the head, it is highly polluting process and it process that. As it looks today may not be feasible to be Made in India, PLI scheme maybe there but definitely it is not an easy nut to crack, but for us derisking on DCDA is increasing the market share from our non-Chinese source and we have a very good relationship. We, as a company, paid them a lot of much higher price compared to China, I am not looking at short-term, so the relation is strong and maybe we can get a maximum requirements from this source and China's dependency will be minimal.

Rashmi: My last question is your total revenue share that comes from B2B customers and from B2C segments?

Krishna P. Chigurupati: I think B2C today is about 35%-40% and 60% is from B2B.

Moderator: Thank you. The next question is from the line of Anirudh Gangahar from Avendus Wealth Management. Please go ahead.

Anirudh Gangahar: Good Morning and thank you for the opportunity, two questions from my side. One could you help us with the stakes of US FDA inspects of your plants which have been due, have they started and can you update us on the status? Secondly just a housekeeping question on the other OPEX which we see this quarter, about 25% from the June quarter, is it largely due to the fixed over costs or is it any other element which we probably normalize?

Krishna P. Chigurupati: What was the second question, can you please, first one was you said we have to FDA inspection, I will come to that.

Anirudh Gangahar: The second question Sir is that if I look at the other operating expenses of 208 crores in the September quarter versus 164 crores?

Krishna P. Chigurupati: On FDA inspections what I understand from your question is are they likely to inspect shortly, if that is the question, yes FDA had started physical inspect. They were doing people inspections, online inspections for some time and actually we went through one of those for our Vizag facility and we went through quite well. That off late they have been doing physical inspections and many plants in India have started getting inspected. In the US of course, we had some two online inspections and one physical inspection so far after COVID.

Anirudh Gangahar: Has the inspections of our facilities started in India as well?

Krishna P. Chigurupati: Our facility, only one facility was inspected online, but we are ever ready. One of our and I would say key strengths is FDA compliance and we always are very happy to say we will never have any data integrity issues. We may have some other problem, but never data integrity issues and all our plants are in good shape.

Sandip Neogi: Regarding the operating expenses increase from the last year similar quarter, the main contributors, our R&D expenses have gone up by Rs. 25 crores, freight increase is around 20 crores, and there is a one-time consultant fee expenses which is incurred in this year is almost 6 crores.

Anirudh Gangahar: So this business from last year-on-year, I was looking more for quarter-on-quarter?

Sandip Neogi: Between June quarter and this quarter, R&D expenses has gone up by Rs. 20 crores and then freight has gone up by Rs. 9.5 crores and there are other manufacturing costs some of the doubtful debt allowances, then FOREX loss, conversion charges, repairs and maintenance in small pieces, so these are like some of the things which had to be incurred in this quarter and if you see the overall kind of a run rate from the last year to the current year, if you exclude all the one-times and exceptions, it is likely that the run rate will be going up by 10% to 12%.

Moderator: Thank you. The next question is from the line of Abdulkader Puranwala from Elara Capital. Please go ahead.

Abdulkader Puranwala: Thank you for the opportunity, Sir just one question on debt considering that in the first half we had certain challenges with regard to the squeezing of margins and the working capital is going high, and as you mentioned earlier on the call, we are spending close to Rs. 300 to Rs. 400 crores this year and similar amount next year, so how do we see the debt position of the company, do we remain confident in that much of this capex should be driven by internal accruals or you will have to raise debt in the near term?

Sandip Neogi: Internal accruals will be the source for funding our capex for this year and future, there is no doubt about it. The other thing is that since our long-term debt is coming down because of continuous repayment which is happening, even if there is a little bit of increase in the working capital requirement based on the increased demand or kind of a strategic decision about making bigger inventory buildup, at a net level the debt position should not change at big time, it should be enough.

Moderator: Thank you. The next question is from the line of Praful Borah from Systematix. Please go ahead.

Praful Borah: Sir, you highlighted the possibility of price hikes on the B2B segment, can you also throw some light on the B2C segment?

Krishna P. Chigurupati: B2C already we have explained, it has just started looking at price increases and B2C is all in the US today for us, so Priyanka you want to expand on that.

Priyanka Chigurupati: The thing is right now like somebody earlier mentioned there is a lot of stocking in the US, so today people are just about starting to see the impact or starting to understand what the impact would be over the next few months or quarters, so based on that they are looking at strategic customers especially for our products based on the history we have had, they do think of us as a strategic customer with the market shares that we have, so we are looking at discussing the cost increases that could translate into price increases with the customers, but there will be a lag, so even if we do pass on the prices today, it will still take us a few months to be able to see that physically effect our numbers.

Praful Borah: Secondly, the spike in the R&D spends this quarter, is it more of a timing issue or this is going to be the new normal now?

Sandip Neogi: Are you talking about the R&D spends?

Praful Borah: Yes, the Rs. 47 crores number.

Sandip Neogi: R&D spend has been in line with our plans, so it is not that there is any brought forward from the earlier quarter, this was the planning and as we kind of progress, this will be our run rate for the rest of the year.

Moderator: Thank you. Ladies and Gentlemen, this was the last question for today. I would now like to hand the conference over to Dr. Krishna Prasad Chigurupati for closing comments.

Krishna P. Chigurupati: Once again, Ladies and Gentlemen, I sincerely thank you for being with us on the weekend and spending your time away from the families. Again, I would like to end this conference on a very positive note that we will be seeing improvement quarter-on-quarter and though this year is going to be a blip, we see the future to be quite exciting and encouraging. Thank you very much once again.

Moderator: Thank you. On behalf of Granules India Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.