



## “Aarey Drugs & Pharmaceuticals Limited Q3 FY2019 Earnings Conference Call”

February 22, 2019



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**Moderator:** Ladies and gentlemen, good day and welcome to Aarey Drugs & Pharmaceuticals Limited Q3 FY2019 Earnings Conference Call, hosted by Kirin Advisors. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing “\*” then “0” on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Sonal Kumar Shrivastava from Kirin Advisors. Thank you and over to you Sir!

**Sonal K Shrivastava:** Good afternoon everybody. I welcome you all to this conference call of Aarey Drugs & Pharmaceuticals Limited for the Q3 FY2019 results discussion. Today on the call we have Mr. Mihir Ghatalia, Managing Director of Aarey Drugs, Mr. Rajesh Ghatalia, CFO of Aarey Drugs & Pharmaceuticals Limited. The structure of the call will be likely, they will first have a brief introduction about the Company and their performance for the quarter and subsequently we will open the forum for question and answers. I now hand over the call to Mr. Mihir Ghatalia for a brief introduction about the company and he will take you through the performance of the company during the quarter.

**Mihir Ghatalia:** Thank you very much Sonal Ji. A very good afternoon and good evening to all the participants and thank you so much for tuning into the conference call to discuss the results of Aarey Drugs for the past quarter. Since this is our very first conference call I would just like to give all of you all a little bit of briefing about the company. We are basically being a trading company, which has been involved in trading and distribution of solvents and chemicals and in 1993 we got registered and we started the manufacturing of pharmaceuticals basically into the Imidazole family, Metronidazole, Methylimidazole, Metronidazole Benzoate and we were manufacturing that until 2008, 2009 and during the same period of time our solvent trading, our importing activities were continuing on their own pace and growing at their own pace. After that we had a small hiatus of manufacturing in the company because of the unfortunate loss of our Chairman Mr. Atul Ghatalia and that had left a void in the company, which it took sometime to get into new products and then in 2015 once again we have invested our own money and we have started manufacturing, we have come up with a new range and new line of products and we want to give away more and more to our shareholders as well and the first step that I guess we have started is by hiring an IR company where the visibility of the company now becomes an apparent part.

Now coming back to what we do, our basic business is divided into two sectors, one is manufacturing of bulk drugs and APIs and the other is about solvents and chemicals. In terms of bulk drugs and APIs as of now we are manufacturing five products in particular, to just give a short brief about the products, one of them Mono Methyl Urea as we term it as MMU, it is the basic raw material for manufacturing of Theobromine. If you ask what is Theobromine required for it is basically heart

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stimulant, it is a medicine that is required as a heart stimulant or it can also be used in countries for dilation of blood vessels and increases urine passage.

The second product that we manufacture is Dimethyl Urea and Dimethyl Urea now is the major key raw material for manufacturing of Theophylline. Once again major products that we are talking about, these are all xanthine alkaloids that is where we are trying to focus all our attention in the coming few years call it the present, call it the future that is how even future integration, forward integration this is the family that we are looking onto, so Dimethyl Urea again it is required for manufacturing major raw material for manufacturing Theophylline, which again it is used for heart diseases, it is used for increasing heart rate, anti-inflammatory, so these are the two products, which are major raw materials and these are APIs.

Now in manufacturing of the bulk drugs we are right now manufacturing Mefenamic Acid that is our own products, we have started the manufacturing of Mefenamic Acid just in the later parts of 2017 or you can say mid of 2018, again the major use for that it is again an anti-inflammatory and used as a painkiller for mild-to-moderate pains, menstrual cramps that is what Mefenamic Acid is useful. The other two products Bromomethyl Dioxolane are famously known as BMD or ONCB, these two are particularly products, which we are doing as a made to order for two special companies who are lifting all our quantities and again BMD and ONCB, both of these are changed that we are looking forward to in the future as well. So this is right now adding to our profits as well as AT the same time it is adding more towards our work.

Coming back now to the other business that we have the older one, which is importing and distribution of solvents and chemicals. We are importers of cargos, we have started our own imports in the past few years, which is related more towards dry cargos, which are used in food products or drum packing, which are used for a lot of manufacturing industries, also we are into trading of other bulk solvents, which we directly import at the ports, namely our major work is done through Mumbai Port, Port and Dahej or Hazira Port and the materials is from there is distributed to all our key customers through the country and we have consumers ranging from the paint industry into the pharmaceutical industry, to the laminate industry, to the rubber industry. We are trying to cater a huge margin even including the food industry as well, so we are trying to cater to a huge market where we can increase our business and at the same time getting more and more business.

Coming to the performance of the last year, our revenue was Rs.78.4 Crores as compared to Q3 of 2017-2018, which was Rs.89.5 Crores. Our gross profit was 1.74 compared to 1.96 of 2017-2018 and again a net profit was Rs.1.5 Crores compared to Rs.1.8 Crores, which was for the year again 2017-2018, so in a nutshell if I could just brief, summarise the entire thing, last quarter has been a little rough I guess on everyone, but one of the major reasons for our decline was once the raw material prices for our Pharma raw materials going up in China. Second crude prices taking a hit because of

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which a huge amount of raw materials they lost their value and it was a conscious effort to make sure that we reduce the amount or the quantum of business that we do in order to make sure that we do not incur losses, but we took a hit on our profit, so yes, so that is what in brief I can let you know about.

Regarding our manufacturing, we have a manufacturing unit located at Tarapur, which has four buildings and we have four particular manufacturing units, out of which we are already utilizing most of them and trying to increase more and more capacity and the way ahead we are looking particularly to increase the utilization of the existing machinery that are there to increase the profits. We are trying to introduce a few more products some of them are already in the pipeline, some of them are in the R&D stage and we are expecting higher margins and higher volumes from those products and at the same time since we have our own purchase we have our own supply chain already in line we want to use this one factor that our procurements are from the right places so in a nutshell reducing our cost and improving our profits, so this is all that I had to say regarding the Company.

**Moderator:** Thank you very much Sir. Ladies and gentlemen we will now begin the questions and answer session. The first question is from the line of Vastubal Shah from AM Securities. Please go ahead.

**Vastubal Shah:** Good evening Sir. I would like to just ask one question regarding your full year performance of last two years your overall revenue has gone down when compared to FY2017 and your profitability has been increased so can you just give me the idea how it is happened?

**Mihir Ghatalia:** 2017-2018 full year emphasized more into production than trading, so that has added value to it although the sales made have gone down a bit than the previous year, the profitability has increased because we have emphasized more into manufacturing side.

**Vastubal Shah:** Just one more question Sir regarding the March quarter will be year-on-year we have seen that March quarter will be your highest grossing quarter; the trend will be continued for this year also?

**Mihir Ghatalia:** Every year March quarter is the best season because typically it is that time when the medicines are used maximum to get a better market as always, we will start preparation from February and March as well that is why there is more demand of all the key raw materials.

**Vastubal Shah:** Okay thank you so much. That is it from my side.

**Moderator:** Thank you. The next question is from the line of Duby Rex from iThought Financial. Please go ahead.

**Duby Rex:** Could you give us some brief about the production details about the Theobromine and Theophylline when you will be starting production?

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- Mihir Ghatalia:** Right now what we are manufacturing are the key raw materials for Theobromine and Theophylline so we are right now focusing on that because this is helping us to reduce our cost and Theobromine and Theophylline they certainly are in the pipeline, but we are seeing how to go towards it because there are another couple of products, which are of high margins, which are there and which will add more and more value to the Company, so we are trying to work both simultaneously giving a little more priority to the other new products, which are there. We were certainly there and we are manufacturing Monomethyl urea and Dimethyl urea. right now most of our customers who are buying Monomethyl urea are the ones who are manufacturing Theobromine they do not have such a high in house capacity and secondly what we have been able to do is achieve a very high purity especially in terms of Monomethyl urea, so our product is giving a better yield for them also, so that is a good news for us because eventually when we do get into Theobromine it will be a good time to do that and getting into manufacturing would not take a lot of time, it is just that we need to see the correct season and then get into the manufacturing.
- Duby Rex:** Okay and you also talked about this China factor playing in the raw material sourcing, how do you plan to mitigate the risk for that going forward?
- Mihir Ghatalia:** One of the major issues that we had from China was for manufacturing of our new product, which was Mefenamic acid, the problem was they had some pollution issues because of which the prices were being that are continuously because the availability itself in China was less, but at the same time, we were also new, our sources were very limited, we have found new sources, as a matter of fact we have found a manufacturer in India as well who is manufacturing the raw material that we are looking for and right now the prices are started coming back to normal so we are going to be making sure that we keep more and more stock and we have improved our sourcing for pharmaceuticals from China now. We are hoping that such a scenario does not unfortunately crop up once again.
- Duby Rex:** Going for what is the outlook for Mefenamic acid, can you give a more brief about this product is it commoditized product or is it like a bit special to do?
- Mihir Ghatalia:** It is a much commoditized product, it is basically used for you can say all the painkillers are using it in a nutshell; it is used for mild to little or severe pains and also used for menstrual cramps. It is basically just an anti-inflammatory and the thing that we are trying to do is we are trying to keep a basket of various products where not everything is just high margins and low volumes. We are also trying to keep a couple of products, which have demand all through the year and Mefenamic Acid is one such, which has demand all through the year. We are trying to keep the ball rolling as well as try out our hand at new products, but yes Mefenamic Acid is a product, which is continuously required all through the year, it is also exported to different countries and it is a product, which is globally in demand.

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- Duby Rex:** Do we do also exports right now?
- Mihir Ghatalia:** Right now, there are two types of markets when it comes to Mefenamic Acid, there is a regulated market and there is an unregulated market. To get into the regulated market, there is a process of nearly six to nine months and where they need to do the stability test of the different batches that we manufacture. They need to do the product test because since these are not like APIs, which are eventually going to be made into bulk drugs. They are just going to formulate these, so they want to make sure that the product is of their quality. We have given it to a lot of places for the stability test. We have given it to a few major companies in India in particular and once we get an approval from them we are going to start approaching other countries as well. We are already talking to a couple of clients outside India, but let us see how that goes in the due course of time. We are hoping to get the results of the stability test from our Indian counter. By hopefully by March end we are hoping that they will give our favourable answers.
- Duby Rex:** Great and Sir one last question from my side, so right now the only API we have is the Mefenamic Acid right?
- Mihir Ghatalia:** Correct.
- Duby Rex:** Going forward, you said you are going to have some two to three products right, are they going to be APIs or they are going to be chemicals?
- Mihir Ghatalia:** APIs.
- Duby Rex:** APIs?
- Mihir Ghatalia:** Yes.
- Duby Rex:** Fine. Thank you so much. All the best.
- Moderate:** Thank you. The next question is from the line of Nilesh Karani from Magnum Equity Broking. Please go ahead.
- Nilesh Karani:** Sir just to understand, your Mefenamic Acid basically how will be the margin risk is for example the prices are stable at certain levels what you expect, so what kind of margin you try to get from that just wanted to understand?
- Mihir Ghatalia:** We are generally trying to obtain a margin of 10% to 15% anywhere in that ballpark because another as I had said during the introduction one of our major benefits is sourcing, so we try and we source at the right time because since we are already into the chemical market that the number of raw materials,

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which are required for manufacturing Mefenamic Acid frankly is a very huge list and since we are dealing with all these products, we know when is a good time to buy, so that is just about the raw material, but yes we are targeting a minimum of 10%, but we will try and ensure that we can go as high as possible.

**Nilesh Karani:** What is the trading right now component in our balance sheet and what is our manufacturing component in our balance sheet right now?

**Mihir Ghatalla:** As of now 70% is trading and manufacturing is 30%, but we are gradually increasing that if you see in the past two or three years we have been gradually increasing our manufacturing component to be a higher percentage.

**Nilesh Karani:** For the last two to three years what was our percentage and now what is the percentage can you just quantify please?

**Mihir Ghatalla:** FY2017, if you see our manufacturing was contributing towards around 8% to 9% and now in FY2019 we have bumped that up to 30%.

**Nilesh Karani:** In sense of terms if it is the number terms, it should be around Rs.24 Crores of manufacturing?

**Mihir Ghatalla:** Yes approximately.

**Nilesh Karani:** What would be the margins from like manufacturing and from the trading?

**Mihir Ghatalla:** From trading very frankly the net margins are around not more than 2% and manufacturing as I said basically depended on product we are 10% to 15%.

**Nilesh Karani:** Basically your balance sheet shows the margins are more just in line with your trading volumes and not with the manufacturing that is what happening Rs.1.5 Crores I think?

**Mihir Ghatalla:** If you really look into the figure, if we talk about last year figures itself, we had around Rs.350 Crores turnover up Rs.350 Crores turnover, the trading was around Rs.300 Crores and manufacturing was around Rs.50 Crores approximately. If you compare on those lines from trading we hardly expect something near to 1% and then the balance we expect is from manufacturing side, so you can very well visualize what are the margins comparatively in that Rs.50 Crores turnover we had around Rs.6 Crores to Rs.7 Crores profitability as compared to around only Rs.3 Crores in trading. If we increase the manufacturing capacity it will definitely improve the thing.

**Nilesh Karani:** Sir just one more question in our plant is now fully like it has been renovated or still there are lots of things to be done, I just wanted to understand on that?

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- Mihir Ghatalla:** The major portion has been renovated. Around 90% of the plant has been totally renovated. If anybody would like to come down, it would be our pleasure anytime.
- Nilesh Karani:** Because last time before two years we had visited the plant and looking at the plant?
- Mihir Ghatalla:** Let me be very frank about it initially we have emphasized only on comments in the production and then now since last one year we have taken up the issue the beautification of the plant.
- Nilesh Karani:** What is the capex that was involved in that beautification of your plant?
- Mihir Ghatalla:** Around Rs.1.25 Crores or Rs.1.5 Crores.
- Nilesh Karani:** Because last time when I had come that I think your pipes and all were there at places and then they told us that it would be Rs.3 Crores and there was one tank you had obtained from shipping house or something?
- Mihir Ghatalla:** Those tanks and pipes what you are talking is just related to the manufacturing side and not the trading side. It is not anywhere related to the beautification side because if you go through our balance sheets, our investment on year-to-year is around Rs.4 Crores to Rs.5 Crores on the additional investment, which we are right now doing it from internal approvals only. Again this year we have spent it on the beautification part because our first emphasize was to commence production and to bring the plant to a profitability level. I think is that okay, you want any further clarifications on that?
- Nilesh Karani:** If it is a fully compliant plan, for example ISO or whatever particularly just you want like...
- Mihir Ghatalla:** We have ISO registration and right now we are applying for GMP also.
- Nilesh Karani:** Correct, so GMP London or what?
- Mihir Ghatalla:** No, first it will be GMP India only as per IP grade. Then we will go for this BP grade and all, but our products already are results of our two APIs, already in line with BP grade, British Pharmacopoeia.
- Nilesh Karani:** Sir like our capacity now if you come to that, if you have planned this then what is the capacity, we are utilizing right now and in what segment we are utilizing the capacity can you just quantify please?
- Mihir Ghatalla:** Right now, we are using around 60% to 70% capacity, but by say 2020 we would be using total 100% capacity, because we are adding three more new products, that stabilization and achieving targets will take some time, so we are thinking by March 2020, it would be 100% utilizing the capacity of the plan.



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- Nilesh Karani:** Okay, in terms of materials, in terms of APIs, how much out of this the capacity and how much is for that asset capacity, can you just if you?
- Mihir Ghatalia:** The capacities vary from product-to-product, but what is the installed capacity I can tell you. When we are talking of Mefenamic it is around 30 to 35 tonnes per month. Likewise MMU is around 150 tonnes per month; DMU is 90 to 100 tonnes per month. Then we are manufacturing OPNA till December it was around 35 tonnes per month, in January we have achieved it 50 tonnes, this month we are targeting 60 tonnes per month. So it varies from product-to-product and as we improvise on the time cycle, batch cycle, everything depends on that and we have to establish in the market also that product. So it takes its own time, but yes within the specified capacities we can increase the production by improvising on the quality and the quantity both and time cycle and everything.
- Nilesh Karani:** Can we say 2020 probably March, would be exponential growth year for us or probably 2021?
- Mihir Ghatalia:** Sorry I did not get you, can you please?
- Nilesh Karani:** If everything is that place, so probably 2020 would be a very good year for us or 2021 would be the best of the year like the whole 100% everything is in the balance sheet like your profitability is seen there or whatever like, margins have been improved like whatever?
- Mihir Ghatalia:** By March 2020, we would be utilizing 100% of the installed capacities as of now. If there is slight variation, we can increase these capacities also, but in March 2021, we have one building which is totally idle and we have plans to start manufacturing over there. So I think by March 2021 we will be using 100% of whatever infrastructure we have.
- Nilesh Karani:** So probably March 2020 would be like 15% our margins and our topline would increase by more than 30% approx.?
- Mihir Ghatalia:** Yes, that is what we are looking at.
- Nilesh Karani:** I mean if I am correct.
- Mihir Ghatalia:** Yes, you are right
- Nilesh Karani:** Thank you Sir. That is it from my side.
- Moderator:** Thank you. The next question is from the line of Vastubal Shah from AM Securities. Please go ahead.
- Vastubal Shah:** I just wanted to know what is our client mix from India as well as from your export market, so what kind of clientele we are serving.

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- Mihir Ghatalia:** As I had said earlier, products that we manufacture, for the API is that we are manufacturing, they are all again, they are using it to manufacture bulk drugs, so the client mix is just people who are manufacturing the bulk drugs and for our export market as I said, the APIs they need stability, they need certain parameters, which need to be there, which takes its own time, so we are getting there and hopefully soon by next year we should be having our own exports to show you, but until then we already have a large number of pharmaceutical companies who are already buying from us and they are using our products and at the same time, they are exporting the products, so in one way or the other we are contributing towards their exports right now.
- Vastubal Shah:** Okay, I just wanted to know total number of customer base you are having like maybe you are having some agreement with your clients to not to disclose, but in terms of total number of clients you have and what is the revenue mix from your top 5 or top 10 clients?
- Mihir Ghatalia:** It depends from product-to-product, we have more than...if you combine our chemical **(audio break) 29:49** we have more than 100 clients, only we talk about the pharmaceuticals. Again as I told you there are two products that we are manufacturing which are only as per the requirement of the clients, we are already there, we are already manufacturing two products, which are going to particular two key customers and other one again it is a demand kind of a thing, again it will depend on the rates, it will depend on the quantity, so we already have around 30 to 35 customers for our pharma products and for chemicals the list goes more than 70, 80 already.
- Vastubal Shah:** Okay, so from the profitability side also, so contribution will be in line with as per the clients, which we are sharing revenue like top 10 clients in terms of revenue and in terms of profit, profitability is the same for the top clients also or you are taking some hit on that part?
- Mihir Ghatalia:** The quantity what they consume, you get things, so if person who was using a larger quantity maybe we have to take a cut on the sales, profitability.
- Vastubal Shah:** Okay, so in terms of your chemical business, there will be from you are having two clients; you are providing the services, so how is your terms with them?
- Mihir Ghatalia:** As far as chemicals are concerned, it is really trading act. It ranges from 30 days to **(audio break) 31:48** clients they give us in LC also, they open an LC and make sales against LC but they are again 50 days LC, 90 days LC.
- Vastubal Shah:** I am not able to hear you.
- Mihir Ghatalia:** Just repeating what we just said when it comes chemical, as it is a trading activity and there we have commitments of certain quantities for a certain period of time, depending on that and that the rates

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and everything they fluctuate on a wide number of factors like there is crude, there is dollar, there is the exchange rate and even other global scenarios, but again in trading usually it is not a customer with large volume gets larger discount, that scenario has not come it just that sometimes our contracts **(audio break) 33:15** make sure that we are well averaged out for any such scenarios.

**Vastubal Shah:** Okay, okay and other question on the working capital side how is your payment terms for your suppliers as well as other customers?

**Mihir Ghatalia:** It varies. See for suppliers when it comes from **(audio break) 33:41** they give us a better rate sometimes we do 20, 80 as well, 20% advance and 80% against shipment when it comes to the people whom we give the material to, there are lot of clients in pharmaceutical who give us LCs, there are some in the pharma the credit terms are usually ranging from 30 days to 60 days not more than that and when it comes to chemicals well our procurements are against LC, either direct credit for DA 90 days and at the same time, by the time the material comes we sell it on similar terms where usually it is the rolling continues.

**Vastubal Shah:** Okay, Sir just one more question, but will be on the your stock pricing side because we are at 30 rupees level from nearly from Rs.150 level. So what kind of selling you are seeing, it is selling from whose side?

**Mihir Ghatalia:** Sir I guess you are a better person to answer that then I am because if you see we have not reduced our stocks even one bit, we have been as a matter of fact increasing the stakes, say for example we bought warrants at Rs.90 also, we bought warrants at Rs.54 also. We are investing in the company and the future of the company and our major role is just to make sure that the shareholders get their worth, we have not in any way contributing towards the increasing or decreasing the prices, but yes if we will talk long term we are sure the way we are ahead with the company and the belief that we have I do not think it should be a problem.

**Vastubal Shah:** Thank you Sir. That is it from my side.

**Moderator:** Thank you. The next question is from the line of Richa Jadhav from an Individual Investor. Please go ahead.

**Richa Jadhav:** Hi Sir, I am sorry I joined the call a little late, would like to know what are the new products that... are we planning to come out with any new products.

**Mihir Ghatalia:** Hi Richa yes we are planning to come up with new products as I had mentioned in my introduction, we are already manufacturing two particular APIs, one particular bulk drug also we are doing to particular APIs to vary segmented plant-related work, we are looking ahead. We are majorly planning

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to get ahead in the xanthine alkaloid family which are majorly you can say drugs for stimulation of the heart and respiratory disorders and you can say anti-inflammatories. Yes, we are working towards that. There are a couple of exciting products that we are working on, but I guess once as and more the time comes nearer we will be sharing more and more information, in the sense everything from development stage we are right now keeping it under wraps and once we are nearby obviously we will be divulging more and more.

**Richa Jadhav:** Okay and Sir, as we mentioned that we will be utilizing the entire capacity this year so are you also looking to had some capital expenditure over next two to three years, since we are planning to come up with new drugs, so maybe are we planning to have the capital expenditure also in next two to three years to expand the capacity?

**Mihir Ghatalla:** Not really, right now see Ms Richa, we are right now investing from our own pockets and until and unless, there is some very huge expansion, I do not think we will be looking for any more capex as of now. Let us see in the due course of time because right now we have all the resources, so you know all that we are working with is a working capital that we have already have and we are trying to put in more and more of that, but nothing more than that.

**Richa Jadhav:** Okay. Thank you Sir.

**Mihir Ghatalla:** Thank you.

**Moderator:** Thank you. The next question is from the line of Ganesh K an Individual Investor. Please go ahead.

**Ganesh K:** Hi Sir I just have a couple of questions, first thing would be related to the manufacturing activity that you had basically stated once again and you said the expected percentage of manufacturing for the total revenue would be 30%. At what rate is it expected to peak out, what rate are you expecting the reach by in the next two or three years?

**Mihir Ghatalla:** I cannot hear you, your voice is coming very low Mr Ganesh I am really sorry I could not, and can you rephrase the question once again please?

**Ganesh K:** Yes, the thing is you have mentioned in the presentation that your revenue from manufacturing is expected to be at 30% for FY2019. So at what percentage you have expected a peak out like in the next two or three years or whenever you expect, when you expect to go up like around 70% manufacturing and 30% trading?

**Mihir Ghatalla:** See we are not in, there will be no such thing is peak, but still if you ask, yes 50% to 70% we want to make manufacturing our main goal and not try and reduce trading but then by saying trying and reduce trading we expect to manufacture more and keep the volumes of trading somewhere in the