



“Granules India Limited
Q3 and 9M FY '23 Earnings Conference Call”

January 24, 2023



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Moderator: Ladies and gentlemen, good day and welcome to the Granules India Limited Q3 and 9M FY '23 Earnings Conference Call. 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 star then zero on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Irfan Raeen from Orient Capital. Thank you, and over to you, sir.

Irfan Raeen: Thank you, moderator. Good evening, everyone. Myself, Irfan Raeen from Orient Capital. We are an Investor Relation Advisor to the company. I hope that all of you and your families are safe and healthy. On behalf of Granules India Limited, I extend a very warm welcome to all participants on Q3 and 9-month FY 23 financial result discussion call.

Today on the call, we have Dr. Krishna Prasad sir, Chairman and Managing Director; Dr. KVS Ram Rao sir, Joint Managing Director and Chief Executive Officer; Ms. Priyanka Chigurupati, Executive Director, GPI and GUSA; Mr. Mukesh Surana, Chief Financial Officer; Mr. Puneet Varshney, GM, Business Finance and Investor Relations. I hope everyone had an opportunity to go through our investor deck and press release that we have uploaded on exchanges and on company's website.

I would like to give a short disclaimer before we start the call. This call may contain some of the forward-looking statements which are completely based upon our beliefs, opinion, and expectation as of today. These statements are not a guarantee of our future performance and involve unfortunate risks and uncertainties.

With this, I hand over the call to MD sir. Over to you sir. Thank you.

Krishna Chigurupati: Thank you, Irfan. A very good evening to all of you, ladies and gentlemen, and thank you very much for attending our Q3 earnings call today. As you are all aware, Mr. Mukesh Surana has joined us as our new CFO, and this will be his first call, and I'm glad to introduce him to you.

A detailed presentation of our Q3 performance had been uploaded on our website and I'm sure all of you would have gone through it by now. However, I will dwell on a few important aspects and later, Mukesh will go into a little more detail. Our current quarter performance had improved year-on-year. It had declined slightly compared to the sequential quarter.

As I mentioned in the earlier calls, we were in the process of changing our 3PL service provider in the US and though this process is now complete, the new company continues to have teething issues and missed out on quite a few deliveries to our customers. This has not only resulted in lesser revenue but also certain failure to supply penalties, both of which had impacted our bottom line.

Overall, I'm personally satisfied with our performance in Q3. We expect the 3PL performance to improve before the end of Q4. Our operational cash flow, though healthy year-on-year, there

has been a decline compared to the sequential quarter. The price erosion in the US continues and we keep on mitigating this by geography expansion and product mix rationalization.

The most important piece of information I want to share with you today is that we recently set the groundwork for our vision of going green, saving the planet and its people and, at the same time, generating positive returns for all our stakeholders.

I want to briefly discuss the dilemma facing our world before going into further details. According to the most recent World Economic Forum study of Global Risk, 6 of the 10 biggest dangers of the future are all connected to our inability to reduce or mitigate climate change, all of which will result in disasters which are unthinkable.

These risks rank even ahead of global confrontation. The greater service that any individual or corporation can provide is to at least reduce this risk in their line of business. It is surprising to learn that the pharmaceutical industry is not as environmentally friendly as we may think. The CO2 equivalent emissions in 2015 were 55% higher than those from the automotive industry. I'm not sure if the pharmaceutical industry is working as quickly to reduce emissions as the automotive industry is.

It is highly unexpected to learn that the emissions from the pharmaceutical businesses increased by 15% between 2020 and 2021, reaching 260 million tonnes of greenhouse gases equivalent to -- carbon dioxide equivalent. When several nations set goals to achieve carbon neutrality by the year 2050 to 2070, big pharma too set goals between 2025 and 2030 with AstraZeneca being the most ambitious with the target date of 2025.

Though this is a very positive step, these dates only apply to Scope 1 and Scope 2 emissions, which form approximately 20% of all the emissions in pharmaceutical manufacturing. Scope 3 generates about 80% of the emissions and it is here that they must focus on supply chain and vendor management, neither of which are simple tasks, until each vendor is incentivized and motivated to work towards aggressive targets.

Further, carbon water tax, which has already started rolling out in Europe for certain products, will come into effect in many countries and also for pharmaceuticals over a period of time and buyers will have to pay for emissions caused by their vendors, which will motivate them to incentivize products with the least carbon footprint.

While this is most common knowledge to most of you, I wanted to set the context for our work towards reduction or elimination of greenhouse gas emissions. Many countries are working on around the clock carbon-free electricity, hydrogen and ammonia. India is most likely to be a leader on this front. Automobiles, shipping, fertilizer and even steel companies are working towards making a net zero by using this initiative.

I was actually surprised to learn that Volvo even made a truck with green steel and run by green energy. At Granules, we always believed in reimagining existing processes, systems, convention and beliefs. We always took the least trodden path.

Now we are reimagining chemistry. We recently entered into an MOU with Greenko, one of the largest suppliers of carbon-free energy, and we'll be partnering with them for supply of power, hydrogen, ammonia, nitric acid and a few other chemicals, which will all be carbon-free, made with carbon-free electricity as the base. On our part, we'll convert some of these chemicals from Greenko to raw materials required for our intermediates and APIs.

We have developed processes for this over the years and we will not use any form of energy or any derivatives of fossil fuel in our processes. We will be located adjacent to the Greenko site and also close to a port. We will be starting with two products, paracetamol and metformin, and slowly expand into other products, which we are working on.

Our target is to have product with the lowest carbon footprint from cradle to port. 90% of raw materials will be made in-house at one site and there will be very negligible dependency on any other company, unless they are also green. During the process, while we maintain our current plants, current and future products which we are working on, we propose to set up additional capacities for these two products to meet more than 50% of the global requirement.

Negligible emissions may happen from a small supply chain and we plan to offset this by carbon sequestering. We are also working on developing carbon sinks by afforestation with select high carbon absorbing plants while still maintaining the biodiversity of the ecosystem. I'm highly excited and could not avoid sharing a few of my thoughts and plans with all of you today.

Research has shown that sustainability-driven companies had always outperformed others and it is my firm hope that more companies or organizations will make sustainability the heart of their operations and create value for themselves, stakeholders while also heal the planet.

With this, ladies and gentlemen, I pass this over to Dr. KVS. Ram Rao, our Joint Managing Director.

KVS Ram Rao:

Thank you, Chairman. Over the last few quarters, I spoke about Granules' long-term strategy of science, technology and innovation. Strengthening the R&D and product pipeline is key to our strategy. We have revisited our product portfolio, which will focus on reasonably short-term and medium-term commercialization. Also, the portfolio focuses on development of controlled substances, both API and formulation, and backward integration of these products.

The emphasis has been on the product leveraging on the current strength of Granules in India and US and also bringing in approach of global cost leadership and sustainability. Enzyme fermentation technology is an area of focus and we have made very good progress on the select set of molecules. For these set of products, we have done work on the genetic engineering of enzymes. Interface work of enzymes and chemistry is under progress. We expect to see the first validation of our enzyme-based APIs by quarter 3 of next year.

On our key product, paracetamol, the supply challenges of PAP are behind us and we are running at full capacity. Our focus is now geared towards significantly improving our paracetamol API capacity along with increasing the yield through continuous process improvements. Our backward integration program or DCDA and PAP are also progressing well.

During the quarter, we have initiated profitability improvement programs across direct and indirect procurement, API manufacturing, finished dosage manufacturing and commercial excellence through consumption and technical levers. We have partnered with a leading global consulting firm and several projects have been initiated and are being implemented, which will make a material impact on our profitability in short to medium term.

As we have communicated, US FDA conducted a pre-approval inspection of our Gagillapur facility from January 9 to 13. We have received 3 form 483 observations. The company will respond to these observations within the stipulated time area.

With this, I hand it over to Mukesh, who will take us through the financial section.

Mukesh Surana:

Good evening, everyone, and thank you, CMD and JMD. Let me take you all through the top financial parameters now. On the revenue side, the third quarter revenue was INR 1,146 crores as compared to INR 997 crores in Q3 of '22 at a growth 15%. This growth is primarily attributed to increased efforts in all major geographies, including USA.

Revenue was flat as compared to Q3 F '22, primarily on account of change of the retail partner, which has impacted our FD sales from GPI in the US, despite having orders in hand. The sales breakup as per business verticals and regions are presented in our investor presentation, which is available on the website.

On the value-add side, as a percentage to sales for Q3 F '23, it was 48.4% as compared to 46.6% in Q3 F '22. Value added as compared to Q3 F '22 is down by 1.3% points, primarily on account of higher sales of API and lower FD sales in the USA impacted by the 3PL partner transition which I just mentioned earlier. Along with that, we have also seen some price erosion challenges in the markets, including USA.

On the EBITDA and EBITDA margin trend for the quarter, we were at INR 231 crores as compared to INR 174 crores in Q3 F '22, an increase of 33% over the previous year, mainly on account of increased business across all major geographies. R&D spend for the quarter was at INR 23 crores as compared to INR 35 crores in Q3 F '22. It is expected that R&D spending will be in the range of INR 35 crores to INR 40 crores in each quarter going forward.

Net debt was INR 894 crores as compared to INR 697 crores at the beginning of the year, mainly on account of reduction in cash position. We did a buyback of shares including transaction and cost, it was INR 311 crores. And there is a deployment of capex funds of about INR 50 crores in our new expansion plan with green initiatives in Kakinada and INR 42.5 crores for land acquisition in Visakhapatnam for expansion.

Cash-to-cash cycle was at 137 days in the current quarter as compared to 138 days at the beginning of the year and 141 days in Q2 F '23. Operational cash flow for the quarter was INR 161 crores as compared to INR 23 crores in the previous year same quarter. Higher operating profits and a focus on working capital management contributed to the higher operating cash flow as compared to the previous year.

Capex spend during the year was INR 194 crores, including the advance paid, which I explained early, INR 50 crores for the latest purchase of land in Kakinada for green initiatives and INR 42.5 crores in Visakhapatnam. Free cash flow this quarter has been negative at INR 32.5 crores as compared to a negative of INR 72 crores in the previous year same quarter. However, it was down from Q2 F '23 where it was positive INR 124 crores. So this quarter, primarily on account of little lower operating cash flow and higher capex spend, which we have just explained earlier, has resulted in negative INR 32.5 crores.

ROCE for Q3 F '23 increased to 25.6% as compared to 21.2% in Q3 F '22. We expect improvement in ROCE year-on-year basis to continue in Q4 F '23 despite higher spends on capex for green initiatives.

With this, I open the floor for questions.

- Moderator:** The first question is from the line of Apoorva Bahadur from Goldman Sachs.
- Apoorva Bahadur:** Sir, I wanted some clarity on the arrangement with Greenko. So if you could just throw some light on the financial viability of these projects, even without CBAM, right, and what will be the type of the structure of this agreement?
- Krishna Chigurupati:** Okay, Apoorva. There is a -- Greenko supply us carbon-free electricity around the clock along with certain other chemicals, like I said, ammonia, hydrogen, nitric acid which they're producing in large quantities with export across the world. The economies are going to be -- the economies of scale are going to be with a great advantage, and there will be fixed price contracts for these products.
- And from these products, like I said, we will be making some other products or other raw materials and finally converting them to our APIs. The advantage is there is no transportation of chemicals, it's all in one site. And green power at a reasonable price is available around the clock and we're also next to the port.
- Apoorva Bahadur:** And how do the pricing at which probably Greenko will supply the chemical, does it hold against the current, say, gray chemical pricing?
- Krishna Chigurupati:** Yes, it will definitely hold against the gray chemical pricing. And the cost of raw material chemicals, which they produce also, for overall cost when you take the total cost will definitely not be more than the gray chemicals.
- Apoorva Bahadur:** Including freight and all?
- Krishna Chigurupati:** When you take into account the transportation and other costs, they'll be at the same price or possibly a little lesser.
- Apoorva Bahadur:** Good to hear that, sir. So where is this site exactly? Sorry. You said that you'll be co-located with them?
- Krishna Chigurupati:** It's in Kakinada in Andhra Pradesh.

- Apoorva Bahadur:** And you said, sir, it's -- it will be a fixed-price contract. What will be the tenure over here?
- Krishna Chigurupati:** I think about 10 years to start with.
- Apoorva Bahadur:** And the structure -- as by structure, I meant that will you be incurring the capex for the renewable capacity or the electrolyzers? Or it will be like a fixed take-or-pay type of a contract straight for the chemicals and the electricity?
- Krishna Chigurupati:** Definitely, we are not involved in any of the capex either for storage of energy or for the electrolyzers. It's all their effort. And the percentage we are going to draw from them, if it's a small fraction of what they propose to manufacture. They're going to plan surprise to the whole world. And what we are going to take is a very small quantity.
- Apoorva Bahadur:** Just one last question, if I may. And again, this is on the costing of the green chemicals. So now as we understand that there is an expectation that this entire -- the hydrogen pricing -- green hydrogen pricing will sort of see a very sharp correction over time. So is there any risk of getting tied to a high-cost source, say, in future, maybe it might decline quite significantly?
- Krishna Chigurupati:** Ten years is not a very long time Apoorva, number one. And number two, when we -- as the pricing with our partners, we have taken into account all the developments that are going to happen in the world for solar panels, number one, wind turbines. And most importantly, we also have calculated the efficiencies that are expected in electrolyzer.
- Electrolyzer technology is going through a great change. So we are very well aware of that, what the future costs will be, what the current cost will be. And we are very cautious in not overcommitting ourselves where we may get ourselves stuck with a higher cost.
- Moderator:** The next question is from the line of Tushar Manudhane from Motilal Oswal Financial Services.
- Tushar Manudhane:** Sir, just continuing with this green initiative. So which all other entities have also sort of tied up at this site other than Granules?
- Krishna Chigurupati:** No. There's no other company tied up at this site as of today. They only have contracts to supply green chemicals to countries across the world and even with our EBIT, even within India. But at this site, there's no other company tied up with them. And we will also be an exclusive pharma company with them. There will be no other pharmaceutical company there.
- Tushar Manudhane:** And sir, this sales getting pushed because of the logistics issue. So any guideline you would like to give that how much of the sales has got deferred for the fourth quarter?
- Krishna Chigurupati:** I think Priyanka is online to share. I think it's where she answers that. Priyanka, are you there?
- Priyanka Chigurupati:** Yes, I'm here but I couldn't really hear Tushar's question. Could you please repeat it?
- Tushar Manudhane:** I'm referring to these logistical issues, so there are deferred certain sales in the US market. So if you could just quantify how much of that could come up in Q4?

- Priyanka Chigurupati:** How much of that will come into Q4, did I hear you right?
- Tushar Manudhane:** Yes.
- Priyanka Chigurupati:** So right now, it is a couple of million dollars of sales that we couldn't hit in Q3 -- at the end of Q3 because of the logistical issues. How much of that will come into Q4 is a question that -- we need to figure it out because they're still having some of those issues in January. We look -- we are trying to resolve it in a few more weeks. So how much of that will come into Q4 is something that is subjective depending on the customers replacing the orders.
- Tushar Manudhane:** And outlook on paracetamol, are you seeing the demand still strong? And how long, maybe a couple of quarters? Or what we could gain, now the incremental businesses is going to be a normal paracetamol business?
- Krishna Chigurupati:** Paracetamol is growing, Tushar. There's a huge growth in paracetamol business at the expense of a few other molecules, and we see a double-digit growth for the next few years. But more than the growth of the market, as you have seen, our model is always to -- I need to use this word, but we cannibalize on other businesses. We are effective, our service levels are great, all the biggest brands in the world trust us. They like to work with us on long-term contracts. And especially for us, there's a lot of demand.
- And when I said that we are not taking into account existing capacity which we are also expanding, we are planning to set up new capacities of more than 50% of the world's requirement. And again, for this, many of -- as long as we are green, there are enough companies in the world who want to tie up long-term contracts with us.
- Tushar Manudhane:** And just last...
- Krishna Chigurupati:** Tushar, the carbon tax and other benefits which people get and the commitments they make, there is no option but for companies to go for products with the lowest carbon footprint.
- Tushar Manudhane:** Just lastly on the -- considering this green initiative and the existing capital expenses, if you could just refresh the capex requirements for '23-'24.
- Krishna Chigurupati:** '23-'24, we are all along planning will be around INR 300 crores, Tushar, but that was taken into existence -- or account DCDA, our formulation capacity increases and some initiatives which Ram Rao was mentioning about, enzymatic reactions and some flow chemistry initiatives. But what we are doing right now is a big initiative, and we feel that in the next four to five years, we should be spending at least INR 200 crores just on this -- INR 2,000 crores just on this green initiative.
- And when we do this green initiative, it's not only paracetamol and metformin that will come out, but there will be a few other by-products and few other chemicals that can also add revenue to us. So in addition to whatever we have planned, this will be INR 2,000 crores extra in about 4 to 5 years.
- Moderator:** The next question is from the line of Yogesh Tiwari from Arihant Capital Markets Limited.

- Yogesh Tiwari:** My first question basically is regarding -- there has been some drop in gross margins on a quarter-on-quarter basis. So is this related to higher sales of paracetamol?
- Krishna Chigurupati:** Yes, Yogesh, you're perfectly right. As you're all aware, API themselves have a lesser margin than the finished dosages. So, Paracetamol API sales have increased and finished dosage sales in the US have decreased. So that's the reason for the drop in margin for last quarter.
- Yogesh Tiwari:** And the second is like on the interest and depreciation also there has been an increase both on quarter-on-quarter and Y-o-Y. So what would be the driver for that?
- Krishna Chigurupati:** I think it's best Mukesh answers that, Yogesh. Mukesh, go ahead.
- Mukesh Surana:** So the finance costs have gone up. Primarily, SOFR the index rates have gone up. The working capital, we continuously want to bring more free cash flow. So you would see that the debts are under control. It's just that SOFR rates are going up.
- And in the Q4 also, we are expecting SOFR it will have a little rise. So interest cost in Q4 also will be slightly higher side. On the depreciation, this -- because of some capitalization we have done timely, there are depreciation which has come in Q3. And this will be quite normal.
- Krishna Chigurupati:** There will be increase in costs, Yogesh, but like you know, we are expecting some new launches and the MUPS block is going to go full commercial with some of the new approvals coming through in the next 1 or 2 months. So increased revenues and increased product -- varied product mix can make up for some of these extra costs.
- Moderator:** We'll move on to the next question that is from the line of Sajal Kapoor, an Independent Investor.
- Sajal Kapoor:** To begin with, I have a small appreciation for the management team at Granules. I've been tracking this business for over two decades now when our sales used to be in the INR 20 crores, INR 25 crores range. Management has clearly executed very well to grow sales by a factor of a double century in less than 24 years, so congratulations for that.
- I've got two questions and both are long-term in nature. Coming to my first question, the DNA of Granules has been in large volume, compliance-led manufacturing of molecules like paracetamol. And so economies of scale has been our competitive advantage, right?
- So while these new recent announcements around bio-manufacturing and green science is clearly a bold new thinking and a new direction. It also means a new set of execution risk and challenges that we have never faced before, right? So what could go wrong in this new approach? What are those potential pitfalls?
- Krishna Chigurupati:** First of all, thank you very much, Mr. Kapoor. You have been with us and tracking us for so many years. My sincere thanks for that. But I think you answered part of your question, our DNA. Our DNA is different. Like I always said, we travel the least trodden path. We don't think like others.

And one of the things we did was large volume products with economies of scale and even large volume products, we never did it in the typical way other people manufacture. There was a differentiated way and differentiate then we went into tablets and into high-volume tablets.

So everything was different. So what differentiates us is our thinking. And this applies to other products, large volume or small volumes. And on this particular front of the new molecules and small molecules, enzymatic reactions, I think it's best that Dr. Ram Rao, who has been working on this for such a long time, answers this.

KVS Ram Rao:

Thank you, Sajal. Just the first question, on the way we are really looking at the new --the shift rather, I call it. So first is the innovation mind-set that need to set into the people. So we already have the leadership in place who have enough experience of looking at these kinds of molecules with such technological options available.

And I think that will help us to really make sure that the pitfalls you have rightly pointed out in terms of how do you look at the product development, how do you integrate the technologies together, and then actually weave out the final product, which will be a combination of separate things. So we looked at it.

So the first thing on the people front, I think we have done enough homework. And we have a new R&D center, which has got opened up about six, seven months ago. The team is in place to take care of these challenges. The second one we are looking at is how do we really get to the world class approach onto this.

So we have certain tie-ups and we have certain partnerships with those people who have built the expertise in these particular areas. And that and with the collaboration between the internal Granules team and the external collaboration, we are pretty confident that the execution engine will actually run. And this is our DNA. We really don't think the way others think.

I think that's what Chairman alluded to, giving examples of green chemistry, the green initiative, coupled with the kind of initiatives that we are bringing on. The portfolio, the shift in the portfolio and the application of the science, technology and the innovation into the portfolio through human capital and also the infrastructure will enable us to lead in, this is my firm belief.

Sajal Kapoor:

That's very reassuring. And my second question is on the 4Q FY '22 call, you were elaborating on the new oncology block and the services-based partnership model going ahead, where you quote, and I'm now quoting yourself, you said that, once our technology strategies kick in, CRAMs will become an important business element in our journey unquote."

So please, can you elaborate the medium-term plans for CRAMs in terms of how many scientists can we integrated? And what kind of additional or incremental infrastructure, we would require to put a credible CRAMs strategy in place?

KVS Ram Rao:

So I think it is -- just to let you know that we made certain initiatives towards the technology and green. Unless these two mature, I think we will not be able to offer a differentiated approach into the area of CRAMs, in the pharmaceutical industry.

So our first step towards the entire journey of considering ourselves as a science, technology and innovation-led organization, we made three, four different moves. The first move, Chairman explained, how do you go green, which is the most important requirement.

The second, by going green on the energy and also based on certain fundamental chemicals, how do you really build your platform of chemical intermediates for pharma, which is both for the current product and also for looking at the future pipeline of the product.

I think we need to establish this platform and then we should be able to really think about a much larger picture of how do we contribute towards the global platform of pharmaceutical industry on a CRAMs mode and otherwise. I think so the stage is set, but it is difficult to put a quick time line to this. But our endeavour -- first endeavour is to make sure that whatever we are thinking, we will get to a degree of maturity.

Moderator: The next question is from the line of Varun Basrur from Julius Baer Wealth Advisors Private Limited.

Varun Basrur: First is, post the INR 1,000 crores capex, which was announced in FY '22 for over three years, I think the exit cap -- the exit gross block would be somewhere around INR 3,100 crores. I understand some of this capex is towards backward integration. Just want to understand what sort of revenue potential is INR 3,100 crores of gross block can achieve at current prices? And over what period of time the management wants to scale up the revenue?

Krishna Chigurupati: While Mukesh answers this question, Varun, just let me explain. This is also backward and forward integration. So revenue will not be the main key here because it's all in the company's advice. So revenue will be eliminated at every stage. However, the profitability will improve.

And all our future investments, whatever we are doing, we are looking at least 2.5x to 3x of asset turns, with this particular model. And I would like Mukesh to add to this.

Mukesh Surana: So some of the gross block which we have are some capex initiatives, which we have taken up and also some initiatives which we are planning to take in the next couple of years. It's a long-term project.

So some of the differentiation and maturity, which Dr. KVS. also was talking about--will get into pay back mode in starting from next few years. So currently, the gross block looks high, but the revenue generation is going to start...

Krishna Chigurupati: I'd just like to add here, Varun, MUPS block, like I said, is going to go fully commercial shortly with the new approval coming through. And that is going to make a large difference to asset turns on capex on gross block.

Varun Basrur: Sir, second question is just building on what our previous participant had asked. If you can split the finance cost into what the debt service cost is. And there's a factoring element also there. What is that factoring of receivables? And what is the cost of funds today, as and at the end of this quarter?

- Mukesh Surana:** So the finance costs, we see it holistically. The factoring cost also indirectly, it's a financing of cost only. There is a significant cost for factoring also. But the difference between the factoring cost versus borrowing cost are not significantly different.
- And the factoring has definitely helped us to bring the free cash flow timely. And so the overall finance cost is primarily because of SOFR movement, which has been ramping up quarter-on-quarter. So every time when fed rate increases, RBI rate increases and SOFR has the impact. So that is what is impacting.
- Varun Basrur:** What is the cost of fund, if you can just -- what was the average cost of funds this quarter?
- Mukesh Surana:** Average cost of funds this quarter is, closer to 5%.
- Moderator:** The next question is from the line of Pujan Shah from Congruence Advisers.
- Pujan Shah:** First of all, I just wanted to ask a question on the raw material easing price -- the price erosion in the US. So could you just get a sense of how much price erosion is done in the quarter on a blended side? And on a year-on-year basis, how --like from the top, how much it has been eroded?
- Krishna Chigurupati:** I think once Priyanka answers, what is the erosion that could be happening in the U.S. Maybe if required, I will answer our mitigation measures, but let Priyanka go ahead and answer that.
- Priyanka Chigurupati:** So if I understood your question correctly, you're asking about the erosion expected for the next year. Am I right?
- Pujan Shah:** Yes, So I'm -- first of all, I'm expecting the erosion for this specific quarter, and the price erosion from the top, so the high which made -- it has made. And that from that how much percentage is...
- Priyanka Chigurupati:** Sorry. Could you please put the phone a little bit away please? Very muffled.
- Pujan Shah:** So first of all, I just wanted to ask that for this specific quarter, how much your percentage of price been eroded. And the second question would be -- like the continuous question would be the -- how much the prices has the eroded from the high it has made in the year-on-year basis.
- So like, let's say, it has made a high. So currently, the price of 60 -- the erosion price is 40. So what is the actual from the high, it has been eroded in percentage terms?
- Priyanka Chigurupati:** It's very different -- I mean, different sets of products, different categories of products have, a different weight of erosion...
- Pujan Shah:** Yes. I wanted to talk on a blended basis. So you can get sensible on a range basis, it's okay.
- Priyanka Chigurupati:** On a blended basis, we can't define it by quarter. But YTD, we expect -- we had a total erosion of roughly around 12% to 15%.
- Pujan Shah:** 12% to 15%.

- Priyanka Chigurupati:** Yes, 12% to 15%.
- Pujan Shah:** And are we seeing this price like erosion is bottoming out due to destocking? Has it been like lesser than the previous quarter and now is becoming -- US becoming stable and predictable in all means? Or it seems still concerning -- is still US being a concerning stage for us?
- Priyanka Chigurupati:** The US market will -- has been concerning and will continue to be a little bit concerning for the next couple of quarters. But that said, prices have bottomed out to a large level to a point that customers, who have quoted very -- without thinking big picture, has gotten out of products.
- So now most of our customers, especially on the controlled and large volume products, which are essentially our bread and butter, are really looking backwards to understand every integration strategy and/or any other strategy that you might have and are paying more attention to the supply chain versus erosion.
- So while there will be erosion year-on-year, the rate at which the market erodes will certainly get better. And I think this upcoming year will not be bad for us in the US market.
- Pujan Shah:** And one last question from my side is from Greenko, which we have made a tie-up. So how many percentage of our raw material is being supplied by the Greenko?
- Krishna Chigurupati:** Basic chemicals, like I said, ammonia and hydrogen, nitric acid, and one or two other chemicals will be supplied by them. And we will use these chemicals to further transform them into other chemicals, which will be used by our products and possibly we'll have some surplus material to sell outside, too. So as of now, I'd say about four, five -- four chemicals, which they'll supply in addition to carbon-free energy.
- Pujan Shah:** And let's say, in four, five years, how many chemicals could they supply to us or something like any blueprint plan we have made, something like that?
- Krishna Chigurupati:** We have not made any blueprint plan. We are working together in the true spirit of partnership. It's a constant innovation that's going on. So we will as we go back, we will get to have new ideas and new ways of working.
- Moderator:** The next question is from the line of Darshil Jhaveri from Crown Capital.
- Darshil Jhaveri:** I just want to congratulate on great set of results and your new green initiative. That sounds very promising. So I would just like to ask about whether our performance currently in the December quarter, would that be taken as a base for our future performance, maybe next year or something? For FY '24, could we have some target of our revenue and margins? That could help me out a lot.
- Krishna Chigurupati:** Mr. Jhaveri, basically let me not talk on quarter-to-quarter. But year-on-year, definitely, there's going to be an improvement. And like I said in the last few calls, there will be creeping up of EBITDA margins and revenues. And we see that path very clearly.

But year-on-year, definitely, there's going to be a good growth and especially with all the new initiatives we are taking, while we can't put a number on it today, I think it will be an exciting journey going forward.

Darshil Jhaveri:

So could--so what could be our--on the backward integration, and so at peak utilization, could you help out with some numbers? That would be very helpful. Like maybe INR 5,000 crores at a 20%, 22% margin. Something or the other, not a specific number, but some range would help out a lot.

Krishna Chigurupati:

It's too early to talk about this Mr. Jhaveri. But one thing, like I mentioned a little while ago, some of our new investments, we are looking at, at least 2.5x to 3x as returns. So we still need to validate this, but they look very promising. And the biggest path here, Mr. Jhaveri is, I don't know if you heard in my speech, if not today, in a few years, the carbon border tax will be implemented.

And people who are buying products from other countries for all the Scope 3 emissions, they're importing -- they're bringing into their country, they have to pay tax or they have to incentivize people like us to make sure that there is no carbon footprint.

So definitely, the margins could be a lot different than what we are expecting today. The world is going through a great change. And I think there's a great sense of urgency and the way we work year-on-year is going to change.

Moderator:

The next question is from the line of Tushar Bohra from MK Ventures.

Tushar Bohra:

A couple of questions. First, on the operations side -- or rather, first, I'll ask on the capex side. Sir, I just want to understand how much of the current gross blocks is not optimally utilized or will get optimally utilized say, over the next few quarters.

Especially, I want to look at some color on MUPS Swiss facility as well as on the Onco block. Since you are planning such a large new capex, it would be good to understand the status of the existing large capex already executed?

Krishna Chigurupati:

Let me answer this about the current gross block before Mukesh steps in. The MUPS block, which was underutilized, maybe we spent about INR 280 crores, INR 290 crores on that. And definitely, they're going to see at least 2.5x asset turn on that very shortly.

And this possibly very decent margins, too. So that's with the MUPS block. The Onco block, there are so many things happening there and that's one of the things that will take a little more time to start yielding. But some of our expansions, which we are doing using enzymatic reactions and all, are going to be made in the buyback side, though not on the Onco block, on the other blocks which we have commercialized. So that also should turn around soon.

And the only asset that may not be paying optimum today, could only be the Vizag site. All other sites are being optimally utilized. And going forward, we are very, very confident about our

capex. And also to let you know, we are not going to take huge debt to put up the capex. We are very confident of our cash generation and cash flows. And I don't see it as a great risk, Tushar.

Tushar Bohra:

Sir, it would be fair to assume that the new capex, obviously, would be put up in phases and we would continue to monitor the progress of, say, a given phase before we commit to greater capex. And what would be the kind of payback period--intended payback period? I know it's too early. But you would have a target in mind for all new capex as to the payback period, right?

Mukesh Surana:

Tushar, currently, as we -- as Chairman has clearly explained, we don't see any issues in terms of the sufficient cash generation from operations, which will take care of the loan for the new capex. And capex, we generally have a payback period anywhere from three to six to seven years.

So depending on some of the small capex's and small debottlenecking, can give a payback period quicker. Some of the large initiatives can be six years kind of payback also.

Tushar Bohra:

My second question is on the operations side. Just an observation from the numbers. This quarter, our other molecule contribution is about 13%, 13.5%, and it was about close to 19% last time around. Quick back-of-the-envelope calculation shows me about INR 40 crores, INR 50 crores, drop in revenue on the other molecules.

Second, US business contribution to overall has increased sharply from 43% to 49%. And this is despite the lost sales in US. And third observation is that my stand-alone gross margin is over 300 bps up quarter-on-quarter, whereas the console margin is down by close to 100 bps. So just help us understand, what's leading to these kind of readings on the numbers front?

Mukesh Surana:

Tushar, some of the breakup we have already shared it in the investor presentation. So--and also it is difficult to tell you what happened in stand-alone to console because in the stand-alone, many a times in Q3 when we have the performance, there are inventory which is dispatched to USA for Q4 dispatches there.

And particularly coming to quarter 3, you are right, there is a mix change and there is a lower sale in FD and PFI and that FD lower sales is primarily also because of that 3PL transition issue, which has been taking some time. It is, of course, for betterment.

The capability of the new 3PL is good in terms of automation and digitization. It's just that stabilization is taking time, and we are expecting in Q4, it would improve. So Q4, we are seeing the mix should be changing. And -- but overall, still the value addition percentage also, we would be improving.

Krishna Chigurupati:

Tushar, let me just add, there was an increase in paracetamol sale to the US, which the margins are not similar to FDs. But now going forward, again, some of these paracetamol sales are going to get converted to FDs to the US market itself. That itself is going to correct. And through the 3PL dispatches that are going to improve, there will be better margins on the regular FDs also.

Tushar Bohra: Sir, just a qualitative follow-up on this, please. Just to understand, so we have, in the past, guided that our other molecules would start to contribute meaningfully. And I understand it's a gradual process for a few years. But by when do we really start to see meaningful traction in the non-para, metformin and ibuprofen?

KVS Ram Rao: So Tushar, as you have likely seen there, the first the drop in the other molecules is not on account of not new products but the products where we are making the low throughputs or low-value additions. That is the products where we have taken a conscious call not to promote the products in the markets where there is no profitability or less profitability.

The second part where we have shifted our portfolio. I've already told in my opening statement that in the short to medium term, we should be able to start seeing both the API and the finished product commercialization into markets in US and other geographies. So that shift is going to really take place.

Probably from two years from now, you start seeing a shift where you will start getting into products, which are of different nature as compared to the standard five products, which we normally have as a part of our commercial basket which occupy a higher percentage.

However, for the shift to go into the direction in a much stronger way, I think our focus will be that four to five years down the line, we will have a dominant segment of new product portfolio coming to launches in various regulated market geographies.

Krishna Chigurupati: And to add to that, Tushar, if you have seen, we have been getting some approvals lately. Today also we got an approval for one controlled substance. And one that's already approved will be mentioned shortly. And the next two months, we are expecting some more approvals.

All these things also will definitely add to our increase in new products market share. So let's see how things go. But what Dr. Ram Rao was mentioning in some of those real, real attractive products with the differentiated chemistries and all, that should take about two years.

Moderator: The next question is from the line of Anirudh Gangahar from Avendus Wealth Management.

Anirudh Gangahar: I've got two questions. First is just on the US sales that, we have not materialized during the last quarter. If they had, what would be the delta in the revenue and probably in the EBITDA level? Whether it materializes in this quarter or next quarter, this is something which should come through, hopefully.

And the second thing -- second query is on the press release that has been given. There's a comment that we are also seeing a price and margin erosion in Q3 and expect a similar trend in Q4. Are we referring to the US market only? Or are we referring to the overall consolidated picture that we are going to see some more margin erosion in the current quarter as well? Those are my two questions, sir.

Krishna Chigurupati: I will do the second question first. And -- we were only referring to the US market, and Priyanka has said, we are already almost bottoming out. Erosion will subside. And also my personal view

is that people were competing to get market share all along because there were no new approvals coming for people because FDA was not inspecting many customers, many of our companies here.

Now the FDA has started inspections, more approvals are coming through. And I don't think people will be fighting for the same market and prices may -- if not go up, definitely may stop eroding, but we will see as we go back. So -- and the other thing what the number should had been there. Priyanka?

Priyanka Chigurupati:

Sorry, I would just say that in addition to that, our view on erosion is pretty optimistic because like CMD said, outside of the approvals coming in, if you looked at the FDA--the trajectory over the last couple of weeks and months--actually weeks for many of the big pharma companies who are essentially our competitors, you will see a weakness. We just had our FDA audit in. And we don't have that weakness right now.

So there are many opportunities that are coming up which we are taking while placing a lot of onus on the longevity of it. So considering that, I do think that customers are looking very closely at the supply chain versus just pricing in the market. So I do see next year will be much better in terms of erosion than we had in the past year.

Krishna Chigurupati:

And I think Mukesh can answer the first question?

Mukesh Surana:

So the USA sales, what probably we might have lost, Priyanka also had clarified earlier to one of the questions, a couple of million dollars is what we would have lost. And adding to that, there is -- this sale is on FD. So that also has impacted the VA percentage and EBITDA percentage.

Anirudh Gangahar:

So that loss of sales would largely be directly flowing to the EBITDA number?

Mukesh Surana:

Yes. The substantial margin on that is because FDs has the highest value addition percentage, so directly to EBITDA.

Krishna Chigurupati:

And also, there was also a failure to couple of penalties, which we had to pay, that also has contributed. Once the supplies are streamlined, the margins certainly are going to improve. They cannot put a number right now, but definitely, there seems to be a positivity.

Moderator:

The next question is from the line of Harith Ahamed from Avendus Spark

Harith Ahamed:

There's a land acquisition in Vizag that you talked about, a spend of around INR 43 crores. This is for which business of ours?

KVS Ram Rao:

So we have acquired the land to look at the continuous flow of intermediates and some of the APIs that we want to put it as a part of our strategic journey. So we were looking at the site, which will have the advantages of looking at it. So the Vizag site is going to focus on these technology-based platforms on flow and the engineering excellence.

- Harith Ahamed:** And on the operating cash flow, there's roughly INR 50 crores reduction versus last quarter, and this is despite the cash conversion cycle improving. So any reasons that you can call out here?
- Mukesh Surana:** The current year operating cash flow has been healthy, INR 161 crores. And the primary reason why the free cash flow is negative is because of the capex. But operating cash flow has been slightly lower than sequential quarter, is on account of some delayed sales, and that has resulted in a little higher side on the deltas.
- Harith Ahamed:** Lastly comment on the paracetamol demand, you've commented that it's been strong. So trying to understand, when I look at the numbers also the last couple of quarters, we've seen a step-up in our paracetamol sales. So any particular factors that's driving this demand? Any disruptions with competitors that's turning out to be a positive for us? Or is it just more customer or contract range from our side?
- Krishna Chigurupati:** Harith, one of the smaller reasons is growth in usage of paracetamol. But the main reason is supply security. We supply to a lot of the biggest brands in the world. And their current suppliers, they don't feel very comfortable with and they want to make a big change to us. And that's one of the reasons we see that there is a good potential as we go by.
- Harith Ahamed:** Last one with your permission, just on the R&D spend. We've been guiding for a step up there to around INR 40 crores, INR 45 crores a quarter, we're tracking roughly half of that. So by when should we factor this set up?
- Krishna Chigurupati:** Actually, some of the filings got delayed, Harith, and that's the reason the cost has come down. And also there has been some efficiencies built into the R&D organization. But the main reason is the delay in filings. So the filing fees and the bio developments and the bio studies, some of them were delayed.
- So next quarter, we should come back to normalcy. And after that, a little more shift in our R&D strategy towards high technology products, I think there could be a little extra increase on R&D spend.
- Moderator:** Thank you. Ladies and gentlemen, due to time constraint, that was our last question. I now hand the conference over to Dr. Krishna Prasad for his closing comments.
- Krishna Chigurupati:** Once again, ladies and gentlemen, thank you very much for spending the evening with us today. And while I personally am very excited with the new journey and also I'm very proud about what we are doing. In fact, I feel that we could be the first pharmaceutical company in the world to make a pharmaceutical API. I was so happy to share all this with you.
- Once again, thank you very much for spending your time with us today. And in case of any further questions on green initiatives, please feel free to write to us. Thank you.
- Moderator:** Thank you. Ladies and gentlemen, on behalf of Granules India Limited, that concludes this conference. We thank you for joining us, and you may now disconnect your lines. Thank you.