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Date: 23rd November, 2022

To,
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The Manager,
Listing Compliance Department,
National Stock Exchange of India Ltd.
Exchange Plaza, Plot no. C/1, G Block,
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Security Code: 532815

Symbol: SMSPHARMA

Dear Sir/Madam,

Sub: Transcript of the Conference Call held on 17th November, 2022.

Pursuant to Regulation 30 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015, please find the attached transcript of the Conference Call held on Thursday, 17th November, 2022 for the second quarter and half year ended 30th September, 2022.

A copy of the said Transcript is being uploaded on the website of the Company www.smspharma.com

Kindly take the same on record and disseminate on your website.

Thanking you

Yours Faithfully

For SMS Pharmaceuticals Limited

**Thirumalesh Tumma
Company Secretary**



“SMS Pharmaceuticals Limited
Q2 FY ‘23 Earnings Conference Call”
November 17, 2022

Disclaimer: E&OE - This transcript is edited for factual errors. In case of discrepancy, the audio recordings uploaded on the stock exchange on 17th November 2022 will prevail.



**MANAGEMENT: MR. VAMSI KRISHNA POTLURI – EXECUTIVE DIRECTOR
– SMS PHARMACEUTICALS LIMITED**

**MR. LAKSHMI NARAYANA TAMMINEEDI – CHIEF
FINANCIAL OFFICER – SMS PHARMACEUTICALS
LIMITED**

**MR. THIRUMALESH TUMMA – COMPANY SECRETARY –
SMS PHARMACEUTICALS LIMITED**

Moderator: Ladies and gentlemen, good day, and welcome to SMS Pharmaceuticals Limited Q2 FY '23 Earnings Conference Call. This conference call may contain forward-looking statements about the company, which are based on the beliefs, opinions and expectations of the company as on date of this call. These statements are not the guarantees of future performance and involve risks and uncertainties that are difficult to predict.

As a reminder, all participant lines will be in 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. Vamsi Krishna Potluri, Executive Director. Thank you and over to you.

Vamsi Potluri: Thank you. Good morning, everyone. Thank you for joining the earnings conference call to discuss the financial performance for the quarter and half year ended September 30th, 2022. I hope everyone must have got an opportunity to go through our financial results and the investor presentation, which has been uploaded on the stock exchange, as well as our company website.

The entire global economy is facing multiple headwinds in terms of sustained inflation pressure on certain input costs, rising interest rates, geopolitical instability and supply chain disruption induced by lockdowns in China. The company continued to maintain a sufficient inventory of key starting raw materials and intermediates along with further focus on backward integration to mitigate such risks.

Despite facing such headwinds along with sharp fall in demand for ARV products, the company's financial and operational performance has been resilient with sharp recoveries in revenues for the quarter at INR 159.4 crores, up by 148% quarter-over-quarter. This performance clearly demonstrates improved product mix especially from non-ARV products, especially towards chronic therapies such as anti-diabetic.

The revenues for the half year stood at INR 223.8 crores. While lowering API pricing, high-cost inventory and negative operating leverage due to fall in demand of ARV products impacted the EBITDA margins and profit after tax. The company has turned EBITDA positive during Q2 FY '23, owing to the favorable product mix supported by the recently launched anti-diabetic segment and pickup in demand across various other products other than the non-ARV products.

This shows the company's quick successful transition to non-ARV products, thus reducing the dependency on the ARV products. The company's recently commissioned ibuprofen facility is growing at a healthy pace on a month-on-month basis and taking a big market share across domestic and export markets.

The launch of Sitagliptin has seen a lot of traction and the company has plans to enter the domestic markets in the same. With sustained efforts and noteworthy backward integration in this space, the company expects it to become one of the flagship products for the company.

Coming to some API segment highlights. Q2 and first half 2023 revenue for the API segment stood at INR 159.1 crores and INR 222.5 crores, respectively. Q2 and first half FY 23 API segment contribution approximately around 99.8% and 99.6% to the consolidated revenue, respectively.

With the API segment, 20% of the revenues came from the domestic market, 80% from the export market, including deemed exports for Q2 FY '23. Within the therapeutic area, the anti-diabetic contributed to around 58%, anti-retroviral category contributed to around 8%, anti-migraine 11%; anti-ulcer to 3%, anti-epileptic to 3%, anti-ED to around 4% and the rest contributed around 13% to the total revenue for Q2 FY '23.

In Q2 FY '23, the company has almost destocked its high-cost inventory. During Q2 FY '23, the pressure on input costs have also decreased. And moving forward, input price stabilization could help the margin increase even further. The ARV products segment witnessed significant disruption in terms of pricing and demand in the past few months. As a result, the company witnessed a sharp fall in the capacity utilization along with impact of revenue and profitability.

Nonetheless, the company was able to successfully launch products in new therapeutic categories, along with increasing the market share of non-ARV products quickly. The company has almost recouped the lost ground in terms of topline and expect the profitability to return to the normalized level by end of FY '23.

Going forward, the company will continue to focus on growing the revenue share of non-ARV products and ARV products and process improvements, the geographic expansion and new product launches. Thank you. And I think we continue the Q&A session.

Moderator: We have a first question from the line of Pankaj Param from Molecule Ventures.

Pankaj Param: As we can see, the revenue share of the anti-diabetic segment has significantly risen this quarter on a sequential basis. So what is our long-term guidance on the same? And in coming quarters, will this therapy contribute in the same way to our topline?

Vamsi Krishna: Yes. I think, again, it's a very good product for us. As already mentioned in my speech, I think we expect this product in the future to be one of the flagship products for SMS Pharma. So, we expect to be one of the largest manufacturer of this product. So this is definitely going to contribute on the topline going forward.

Pankaj Param: Could you give us a bit, number as a percentage of the topline for the same product?

Vamsi Krishna: So see, I think this quarter, I think roughly it contributed to around 58%. Obviously, because it's the launch, the contribution is obviously very high. But going forward, I think it will be around 25% to 30% approximately on the topline.

Pankaj Param: And what kind of revenue and margins are you...

- Vamsi Krishna:** The anti-diabetic segment, not just one product. I'm just talking about the entire anti-diabetic segment.
- Pankaj Param:** And what kind of the revenue and margins are you expecting for the full -- for the whole revenue of the FY '23?
- Vamsi Krishna:** So it is on track with the projections that we have given. I know I think Q1, I think we've obviously not had a very good quarter in Q1, so which I think Q2, the bounce back was there. So, the Q2 numbers were in line with what we projected. But again, I think more or less, it will be to the line that we've actually given...
- Pankaj Param:** And in terms of EBITDA margin, it will be back to our mid-20s kind of range in the single digit?
- Vamsi Krishna:** So this year will be -- there is lot of pricing pressure and there's a lot of issues with the entire global scenario is not very conducive and because there is -- because of the impact of COVID is currently impacting the pharma industry right now because I think there's a lot of stocks at the frontend where stocks are not moving and indirectly there's a lot of inventory with the customers. So, because of this issue this entire year, we expect the margins to be -- I mean, obviously, it will improve going forward, but in the similar range. But next year, I think, definitely, I think it will be a better pace.
- Pankaj Param:** And lastly, what is your capex guidance for this year?
- Vamsi Potluri:** So I don't think there is any significant capex that we've planned for the next one year because we want to consolidate right now. So I think the small capex that we planned is something related to the environmental capex with respect to multi-effectiveness operator in ME and other things. But nothing in terms of building new blocks or adding more capacity because I think as was mentioning, I think because of ARV products not picking up too much, I think we have sufficient capacity to fill in more products. So that is the aim right now to identify and fill in the capacity with more products. So, capacity expansion is not there at this point of time.
- Moderator:** We have our next question from the line of Ritesh Oswal from Opal Industries.
- Ritesh Oswal:** Congratulations for good numbers. I have one question in chemo JV, what is the profit sharing ratio in addition to transfer price?
- Vamsi Potluri:** So the profit sharing is 45%, 55%.
- Ritesh Oswal:** Domestic also?
- Vamsi Potluri:** Yes, everyone everywhere around the globe...
- Ritesh Oswal:** And the -- every quarter-to-quarter, it is settlement or year-end?

- Vamsi Potluri:** Yes. So once a year, we are settling it.
- Ritesh Oswal:** Okay. So in this quarter, that 45% not reflected till date.
- Vamsi Potluri:** Yes. So the thing is the 45% is typically when we sell it to outside companies. So if it is for own consumption, we it's just on a transfer price basis only. either for SMS or for chemo, so that's the agreement. So if sell it to third-party customers, then the profit comes into play.
- Moderator:** We have a next question from the line of Prafull Rai from Arjav Partners..
- Prafull Rai:** Yes. My question is on the margin. So you said you will start seeing the margin recovery from fourth quarter or by fourth quarter, what is the kind of margin trajectory you are looking at for the next 12 to 24 months? And how will it move up from here?
- Vamsi Potluri:** So we are, again, Q4 onwards, I think we are again anticipating to come to around 15% to 18% margin back because I think the margins right now are little still right now. But yes, I think going forward from Q4 onwards, I think we are expecting it to bounce back to that range of 15% to 18%.
- Prafull Rai:** So will we see same thing in Q4 or sort of -- it will happen in the financial year 24 only?
- Vamsi Potluri:** Q4, you can see start seeing the trend definitely sees the profit margin definitely is impacted by the product mix. All the product has different obviously, different margin. So high profitable product is going around, moving a little higher, then obviously, your margins will cross that threshold. So on an average, we were mentioning around 15% to 18%.
- Prafull Rai:** Right? The volumes have stabilized sort of from here will be a gradual ramp up in volumes, and we'll start seeing a margin expansion in a gradual manner, which will continuing in FY '24 also A right assumption to have?
- Vamsi Potluri:** That is correct.
- Moderator:** We have our next question from the line of P.D. Gupta from Investors Forum.
- P.D. Gupta:** Good morning. Okay sir, first at outset actually congratulate that the company's back on track, so for the top line is concerned. And hopefully, this in future, we are expecting that our bottom line will also improve as you have already told about the reasons for that. Sir, my question is only one that we are having an inventory of INR 261.6 crores as on September 22. How much this pertains to our finished goods means in form of API? And how much in raw material?
- Vamsi Potluri:** So just a second, I'm just pulling out those numbers. So around INR 210 crores is WIP and raw materials and INR 50 crores is finished goods.
- P.D. Gupta:** So INR 50 crores as finished goods and INR 210 as raw material.
- Vamsi Potluri:** Raw material and a work in process. Intermediates different different stages, yes.

- P.D. Gupta:** And sir, rather than the item also which is not moving in the inventory any?
- Vamsi Potluri:** One of the major items is, I think, for a COVID product. I think Molnupiravir],I think not only as I think on most major companies who've got licenses have huge inventories of this product. But unfortunately, fortunately, or unfortunately that the spread has curtailed. So not much of a product moving, but though the company is using its resources to try and sell in ROW markets where we have license for this product to sell from the innovator. So that product is under WIP. So this is one of the largest product. The company is finding ways to see and try and liquidate the product.
- P.D. Gupta:** Can I have some figure out of 210 of that amount of that...
- Vamsi Potluri:** Around INR 50 crores, INR 50 crores, INR 55 crores, actually.
- P.D. Gupta:** Around INR 50...
- Vamsi Potluri:** 10% to 15% -- of the total...
- P.D. Gupta:** 10% to 15%. Okay. Sir, one more thing. Actually, we are exporting our Sitagliptin, a major portion exporting to Spain, whether this is going to our JV only or some other...
- Vamsi Potluri:** Is for our JV -- our partner is -- they have launched the product in Europe. So this is for them.
- P.D. Gupta:** So this is going to JV only. But in our quarter, September, this JV, we had not contributed anything in our turnover in top line?
- Vamsi Potluri:** So it is direct sales. So it will not reflect here because this is the transfer price that we are doing. So it will come as under sales. It does not come under the JV. Only the profit is being booked under the JV.
- P.D. Gupta:** So that will come in the future.
- Vamsi Potluri:** For outside third parties that I was mentioning earlier, right? So if it is to our own companies, it will just be the transfer prices. But if it is third-party sales, it will be the profit.
- P.D. Gupta:** Sir, one more thing. What is our installed capacity of sitagliptin and by which time, we will be able to get it 100% or 90% to that extent?
- Vamsi Potluri:** So see, I think in installed capacity, we have enough capacity like around 30 tons per month is our capacity. And you have to note that only right now, only Spain and domestic markets and few ROW markets are open on the patient side. US is still not opened on the patents. So obviously, the volumes will be limited. But once the US opens, the volumes will be much, much higher. So After US will open late 24.
- P.D. Gupta:** US is not open for us, US and other companies have they gotten the patent in the US.

- Vamsi Potluri:** Yes. So it's not a generic product in the US yet.
- Moderator:** We have a next question from the line of Deepak Poddar from Sapphire Capital.
- Deepak Poddar:** Thank you very much, sir, for the opportunity. Sir, first I wanted to understand, I mean, before the situation because of our ARV product and even the global scenario, I think that there were a period of 5, 6 quarters where we were consistently doing a 23% to 25% kind of EBITDA margin rate. I mean, is there any thought process that we can go back to that similar kind of level or because of the ARV issue, that kind of level would be very difficult to achieve for us as we go into future ?
- Vamsi Potluri:** See, I think the ARV is something it is opportunistic, okay? So I think ARVs, are dependent on our partners like Mylan and a few others to for them to back the contracts with the government because we are not into front-end formulation. So we are depending on some of our partners to back this. So definitely, it's all tender business, right? So until the tender is open and closed, we will not know who has bagged the tender, right?
- So it is that is very opportunistic business. So what the company has decided is to let that keep going as it is. And also focus on our own products, where we are dependent on our own sales, our own marketing team. So that's the idea of introducing some good products. So in that perspective, we introduced some high-volume products where the EBITDA margins are obviously in the lower side, like Ibuprofen where the margins are very, very low.
- And also Sitagliptin also the -- like there are hardly any margins because we are just trying to get a good launch and try to get a good market share and try to get a good customer base on these products. So that's the reason the margins and all we are seeing a limited on the margins.
- Deepak Poddar:** So basically, what you're trying to say is that based on our current product profile, currently sustainable margin would be in that range, 15% to 20%, right?
- Vamsi Potluri:** Yes, 15% to 20% for sure, we can sustain from Q4 onwards. I think we will sustain even earlier. Again, definitely depends on the product mix and suddenly, we get another tender. So that is bonus. So what we are considering ARV is as bonus rather than having them having us depend on them. See, in the past, we used to have them contribute to around 40% or 42% even in the past, actually sometime around 60%, 65% contribution of ARVs only on the top and bottom line. So now that dependency, I think this quarter, I think it is less than 8% -- so again, so that dependency we are reducing. So I mean, keeping the top line still going, I think, meaning that our products have taken up some of that burden. So that's the plan going forward for the company.
- Deepak Poddar:** I mean currently, what was the share of the ARV products revenue mix?
- Vamsi Potluri:** 8%, yes. From 40% to 50%, it reduced to 8% right now.

Deepak Poddar: And the -- one of the previous statement, you mentioned that our growth, we are looking as per the guidance. So I'm not aware of what the guidance is for the company. If you could just reiterate that, that would be helpful.

Vamsi Potluri: Okay. So the guidance for the company is push more of our products, though it is that -- so we've built huge capacities. We've got almost 2,000 KL capacity in our Vizag plant, so which is one of the largest in Ibuprofen, we've set up a huge capacity. So to use our capacity and add more product mix and do a little more push more on the marketing side and add more customers to our current existing product mix and increase our sales top line and add a few more products that are in our pipeline of good volume products. So that the company will be sustainable without expecting any revenues on the ARV. So again, if ARVs comes in, that will be another bonus. So rather than depending on some of these ARVs for us to have a top line.

Deepak Poddar: So what is the growth outlook we have given? I mean is it 20% growth we are looking...

Vamsi Potluri: The 20% growth outlook, yes, is what we are projecting for next year.

Deepak Poddar: For FY '24?

Vamsi Potluri: '24 yes.

Deepak Poddar: And FY '23...

Vamsi Potluri: '23 is a difficult now. Again, FY '23, see whatever we projected, we think how much...

Lakshmi Narayana T: The projection -- 10% is already up to Q2 to 10%. And now...

Vamsi Potluri: So Q2, we are already up by 10% to what we projected. But the problem here in FY '23 is Q1. We had a very -- I mean, like not very good Q1. So because of that, it might have an impact on our entire yearly sales, but we are trying our level best to be very close to what we have projected in 2023. So that is around -- roughly around 10% growth from last year.

Deepak Poddar: So that is about INR 520 crores to close to 10%, maybe INR 550 crores, INR 570 crores...

Vamsi Potluri: Correct. So right now, half year, if you see our run rate, I think our half year is running INR 225 crores already -- so INR 223 crores. So we are in that net run rate of being up there. And we had a good quarter and where some of the ARV tenders go our way. Definitely, I think you can expect a very good bounce back.

Moderator: We have our next question from the line of Ritesh Oswal from Opal Industries.

Ritesh Oswal: Have you got a CEP for ibuprofen?

Vamsi Potluri: Yes, we have received CEP in the last quarter.

Ritesh Oswal: You can expect export to European clients soon?

- Vamsi Potluri:** Yes, absolutely. Absolutely. We've already -- but regulated markets will take time, right? So we are on a qualification with many of the customers. So definitely, I think we are working on those lines.
- Ritesh Oswal:** There will be some time for validation or something?
- Vamsi Potluri:** Yes. That's correct. Validation filing.
- Ritesh Oswal:** Seven to eight months approx?
- Vamsi Potluri:** Yes, approximately 6 to 8 months.
- Moderator:** We have our next question from the line of Aditya Sen from Robo Capital.
- Aditya Sen:** I just wanted to know what's the capacity of utilization for Ibuprofen in terms of metric tons per month.
- Vamsi Potluri:** So right now, I think to the initial installed capacity, we are already at roughly around 50%.
- Aditya Sen:** 50%.
- Vamsi Potluri:** So significant growth is already happening right now. We are already what was initially planned and installed capacity. We are at 50% right now.
- Aditya Sen:** It would be like 250 metric tons per month. Am I wrong in this?
- Vamsi Potluri:** No. I think we initially set up for 300 tons. So that is 150 tons.
- Aditya Sen:** 150 tons.
- Moderator:** We have a next question from the line of Viraj Shah from Shah Investments.
- Viraj Shah:** So I have a couple of questions. What is the demand and pricing scenario in the ARV segment?
- Vamsi Potluri:** So again, ARV, we are a contract manufacturer. So definitely, I think pricing, we are not very much involved because I think they have partners this thing to bid for those tenders. So we are not too much involved. So once we get our orders, we work on CMO basis.
- Viraj Shah:** And on demand side, what is the demand...
- Vamsi Potluri:** The demand side, again, it depends on the tender. So the demand is obviously there. So whichever company will be able to get a tender on the front end, we'll be able to supply the product.
- Viraj Shah:** And our trade receivables have been increased in the last six months. Are we facing any issue on working capital management – because of increase in revenue?

- Vamsi Potluri:** So see, the reason that we've done is now increase of our top line is based on our own product mix. So that's the reason I think there is more working capital. And also, I think because of our own sales because procurement, everything, we are not doing CMOs for any companies. I mean CMO diligent like some of the ARV CMOs have reduced. So we are doing our own procurement. So that's the reason that this thing on the working capital has increased.
- Viraj Shah:** Is this more from domestic side or export side?
- Vamsi Potluri:** It's for both.
- Moderator:** We have a next question from the line of Aditi Sawant from ADM Advisors.
- Aditi Sawant:** For the opportunity. I have two questions. First of all, in our anti-migraine segment, how much percentage of total segment sales come from our top three products, which are Sumatriptan, Rizatriptan and Eletriptan?
- Vamsi Potluri:** I think majority of the sales, I think almost 90% of our sales will be from those top three products.
- Aditi Sawant:** And the second question is, are there any other recent patent expiries that we are aiming to launch in the upcoming quarters?
- Vamsi Potluri:** Upcoming quarter, no -- nothing else...
- Moderator:** We have a next question from the line of Rohit Balakrishnan from ithubought PMS.
- Rohit Balakrishnan:** So I'm a bit new to the company, so pardoning some of the questions, if you've already answered them in the past conference. So first question was a bookkeeping question, was what is the debt on our books currently?
- Lakshmi Narayana T:** Just a second. Yes, the second -- is the debt since we already disclosed into the balance sheet and my website as well as the NSE and BSE. As of now, the long term debt is INR 170 crores, and the short term is about INR 90 crores.
- Rohit Balakrishnan:** And what is the cost of borrowing right now?
- Lakshmi Narayana T:** So the cost of borrowing is on an average below 8%.
- Rohit Balakrishnan:** Sir, you mentioned that your focus would be to sort of introduce new products and do more of your own sales as a long-term strategy. So any from a three, four year perspective? Would -- I'm removing the ARV sales, as you said, that's more of a bonus. I think so your aspiration would be to be in that band of 15% to 20%? Or are you also planning to introduce new products, which may have a higher margin and can improve your margin profile from -- on a steady state basis also?
- Vamsi Potluri:** Yes. See, definitely, I think when we are developing the products, right? So we have a mix of both high volume and high margin products. So we have definitely doing in R&D. But our prime

focus is to fill up the capacity that we already have. As I mentioned it, we have almost 2,000 KL available in our Vizag site, which is huge capacity in terms of volumes.

So we would like to first fill up the capacity with good volume products parallely, we have another unit where we do niche and small products. So definitely, I think both types of products are our priority. But initially, we would like to keep it at 15% to 20%, while we backward integrate and we launched a few other high-value products. Definitely, I think we could see a rise from the 20%. But just to be realistic, I think 15% to 20% is something that can be achievable.

Rohit Balakrishnan: And in terms of our backward integration today, so what is the level of backward integration that we already have in terms of our raw materials?

Vamsi Potluri: So key starting with materials, we manufacture them in-house. So slowly, one of our other key starting materials will be manufactured in-house, and we are working on a lot of process improvements at our R&D and our plant trying to see if we can reduce the cost -- so that's the plan.

Rohit Balakrishnan: And sir, FY '23, you mentioned your sort of what you want to -- I mean, what do you think you can achieve? What about '24, mean how do you think for the next year?

Vamsi Potluri: So again, so the major driver for 2024 will probably be Ibuprofen. So our target is to go at least and to increase the capacity even more with respect to our in-house process development and try to optimize capacity even further. So yes, I think our major focus would be to be one of the largest manufacturers of ibuprofen. So that will be the key focus driving point.

So apart from that, we have a few other good volume products. And we have a few other territory challenges that we want to penetrate and we want to register our products in some of the territories, which we were not able through till now. So now that is the focus of the company going forward.

Rohit Balakrishnan: So in terms of growth, like what kind of growth 15%...

Vamsi Potluri: Yes, I think around 15%, you can take around 15% to 20%.

Rohit Balakrishnan: Sir, one more question in pardon again, my [inaudible 0:31:32] So you mentioned that most of your products are -- I mean, ibuprofen is a very high competition product and even the other products that you mentioned, Sitagliptin also high competition. So and you're saying that margins will go up. Is it largely driven by capacity utilization and operating leverage?

Vamsi Potluri: It is like the -- obviously, when you start using more capacity right your overheads tend to come down. So your -- once your overhead tend to come down. Also, parallely we will work on the product. We will see if we can reduce any cost anywhere and backward integration. And so in such ways, we will be looking to increase the margins.

- Moderator:** We have our next question from the line of Atul Kothari from Progwell Securities.
- Atul Kothari:** Sir, just a couple of questions. My first question is, sir, your notes mentioned that there were no operations in your JV during this period. So what is the reason behind the same?
- Vamsi Potluri:** I'm sorry, could you repeat your question?
- Atul Kothari:** You not mentioned that there were no operations in your JV during this period. So what is the reason behind the same?
- Vamsi Potluri:** Yes. So JV company is just used to file our products actually. So the -- all our DMFs, everything will be part of our JV company. So right now, as of now, we do the sales to our JV partner and we reconcile once a year. I mean, once a quarter we reconcile, but once a year, we square it off. So that's the reason like probably you will find that in the fourth quarter.
- Atul Kothari:** Sir, but you have given a guidance of close to 15% to 20% of revenue contribution from the JV company. So are we still sticking to those targets?
- Vamsi Potluri:** I don't think we've given any such projections of 15%, 20% from contribution from our JV. So we were mentioning about our entire top line in the company. With respect to the JV, we've actually not given such projections.
- Moderator:** We have a next question from the line of Abhishek Dave from Bright Securities.
- Abhishek Dave:** I wanted to ask two questions. First, sir, on the last con call, you mentioned that the ANDAs for VKT for Ranitidine was on a stand still. Is there any update on the same?
- Vamsi Potluri:** No. It's still on stand still. Obviously, there's a little more time-taking process. So I think it will easily take one, two years actually.
- Abhishek Dave:** So in VKT, this is regarding the commercial launches that we have done in the past few months. How is that panning out? If you could give us some color.
- Vamsi Potluri:** Yes. So definitely, I think the commercial launches have happened, and we are getting repeat orders. Now we are getting continuous monthly forecast. And apart from these, I think we have closed a couple of big CMOs at VKT side also, so which are already underway. The contracts have been executed. So I think those will come into revenues from June onwards coming June onwards. We will be seeing commercials from VKT on the CMOs. So with those CMOs, I think the facility will be almost 80% occupied.
- Moderator:** We have a next question from the line of Priyanka Shah from NM Securities.
- Priyanka Shah:** I have one question. Sir, what is the R&D spends for the quarter and H1 FY '23?
- Vamsi Potluri:** Just a second, so around 2%.

Priyanka Shah: For the quarter?

Vamsi Potluri: Yes.

Priyanka Shah: And H1?

Vamsi Potluri: H1 is all..

Lakshmi Narayana T: H1 also will be around that 3% range. 3.5%.

Moderator: We have our next question from the line of Amar Mourya from AlfAccurate Advisors.

Amar Mourya: Sir, in your revenue growth, what would be our volume growth in this particular quarter?

Vamsi Potluri: So volume will be higher only. I mean like you mean to say, current quarter or the month that we...

Amar Mourya: Yes, current quarter, let's say...

Vamsi Potluri: Again, volume growth will be on the higher side only because I think compared to month-on-month, we are adding more volumes of ibuprofen. So definitely, I think volume-wise, definitely, there will be a growth compared to the previous quarter.

Amar Mourya: When you say previous quarter, meaning sequential or year-over-year?

Vamsi Potluri: Sequential, and year-over-year as well. In terms of volumes that I'm talking about volume of product moving out of the facility.

Amar Mourya: So sir, if you can help, because overall, if I see the revenue has degrown by 8.7%. But let's say, what would be the volume growth on a year-over-year basis?

Vamsi Potluri: Volumes 30% actually. 30% to 35%.

Amar Mourya: 30% to 35% volume growth. So basically, whatever it is there, it is the price correction?

Vamsi Potluri: Correct. And different product mix, right. So you cannot compare the volume because last year, we didn't have ibuprofen. Now this year, we have ibuprofen, but ibuprofen obviously, top line will be like single, I mean, like it's a very small this thing, right. So margins also will be single digit, less than single digit. So volume automatically will pick up because we are doing like per month, 150 tons of ibuprofen for now at least. So obviously, this sale, we were not having the last year. So obviously, in terms of volume, it will definitely be an increase.

Amar Mourya: And secondly, sir, in terms of the gross margin, is it the gross margin depletion is largely because of the revenue mix, or there would be a high-cost inventory into the system?

Vamsi Potluri: Both it's a combination of both actually, high-cost inventory that we are doing, also pricing pressures that we are currently facing in the market, as I was mentioning, right. So a lot of

inventory out there. So the price pressure is severe because of lack of demand, the supply is more and demand is less. So you know you have that pressure on the pricing where people start reducing the prices. So that price pressure we are facing right now. And we also have some inventory that we are currently with us. So it's a combination of both. So some of this inventory, we obviously bought it at a little higher price back then, so that not being moved and pressure on the front end is actually resulting this.

Amar Mourya: So is it like, sir, now that high-cost inventory going into the Q3, is it over or still the pressure would be seen in the third quarter as well?

Vamsi Potluri: It's more likely it is over. I think it might tail off slowly. I think for fourth quarter, for sure, I think we can definitely say that, that will be over. But Q3 also, you might face some of these challenges.

Amar Mourya: So, let's say, sir, if I see your overall gross margin mean, right, I mean, I'm just barring the best period that is 44%, 45%. Earlier, normally, our mean of the gross margin used to be something around, let's say, 37%, 38%. So I mean, we will reach to, let's say, 37%, 38% in fourth quarter or in third quarter?

Vamsi Potluri: From fourth quarter onwards actually.

Amar Mourya: So meaning in third quarter also somewhere near to the current quarter gross margin kind of thing?

Vamsi Potluri: Would definitely improve further. But hopefully, we can definitely improve it than what it is right now. But it will not be at that range of, so but it will slowly, you will see a positive trend that is the hope we have.

Amar Mourya: So something around 30% to 33% gross margin is possible in the third quarter let's say, 37% in the fourth quarter?

Vamsi Potluri: We cannot tell at this point of time. But definitely, you will see something that is better than this, but not as much as 35%, so...

Amar Mourya: And sir, basically, in terms of the new capex, which we had done, right? I mean what kind of the peak revenue is possible from these new capacities?

Vamsi Potluri: Again, we told you right once ibuprofen is fully 100% occupied with some process improvements I think it can reach around INR 600 crores, INR 700 crores top line.

Amar Mourya: This is at that ibuprofen level, right?

Vamsi Potluri: Correct. So only the recent capex expansion is for ibuprofen only.

Amar Mourya: And any solace is for ibuprofen prices? Like are they further dropping from the current level also?

- Vamsi Potluri:** Yes, further dropping and we are ready for the challenge also. So we are trying to reinvent ourselves to see and sustain in the market.
- Amar Mourya:** So that spread reduction, how we will be arresting, sir, that in that case?
- Vamsi Potluri:** So again, so at some point of time, it has to bottom out, right. So we feel that it's more or less almost bottomed out actually at this point in time. So yes, so going forward, again, it will be around this level or maybe slight upward trend based on the market correction or market scenario right now.
- Amar Mourya:** So when you say 600 potential is on the current price level, correct?
- Vamsi Potluri:** No. We cannot discuss pricing at this point. And I mean...
- Amar Mourya:** I'm not asking the price, but I'm just saying that the revenue potential of INR 600 crores is based on your current ibuprofen prices?
- Vamsi Potluri:** Yes, you can say that, yes.
- Moderator:** Thank you. We have a next question from the line of Rohit Balakrishnan from iThought PMS.
- Rohit Balakrishnan:** Yes. So you mentioned -- two questions. So one, you said that to the previous participant that gross margin could be around 36%, 37% next year. I mean, over a longer term, let's say, over two years, three years, do you see that, that gross margin band would be something that you will operate or that can go up as well? Or do you see any risks for that? I'm excluding any unexpected events, let's say, like FY '22 where it's went up very high or even if it can go very low also. But I'm just saying on a normalized level, what do you see the gross margins to be for your business given the product profile that you are now getting into?
- Vamsi Potluri:** Yes. So I think it will be in that range, I think, around 30%, 35% because we are looking more at top line right now and probably high volume and top line will come in again, based on the top line, I think next two years, around 30%, 35%, I think it will be around that range actually.
- Rohit Balakrishnan:** Around 30%, 35%.
- Vamsi Potluri:** Around 35%. But again, see, when you talk about 2022, right, so that was sudden we've done some COVID projects and so you know that is an outlier. You cannot configure as a normal regular this thing. So again, you cannot predict, right? So you never know sudden there could be a shortage of one product, and we could rely it on that. And obviously, at that point of time, wherever it is possible, obviously, the company will put its full effort to increase the sales and margins. But yes. So on an average, I think that will be the thing.
- Rohit Balakrishnan:** And just two more questions. On your, you mentioned that there's a significant amount of inventory given the last two years COVID, etcetera, in the overall channel, how do you see the destocking panning out I mean, what is your sense that what kind of time it may take because we are hearing similar news across multiple industries. So I mean, just wanted a sense from you.

- Vamsi Potluri:** No, I think it will not definitely ease off in a one quarter or two quarter. I think it will take two, three quarters to slowly move out the inventory that -- we are also seeing some good this thing in this quarter and maybe good projections in the next quarter also. So I think from our standpoint of view, I think in the next couple of quarters, I think you could definitely see some inventory moving out. But at the same time, we are doing some high-volume products where now at this point of time, definitely, I think it will not come back to the previous levels that it was there because some of the volume products that we are doing, definitely, there will be an increase in inventory level. But the old inventory will definitely move up in the next two quarters.
- Rohit Balakrishnan:** And the final question was around to, I mean, if you look at a cost below gross margin, and I mean, basically, cost below gross margin and above EBITDA, so that's around INR 120 crores for a year roughly, so I mean how do you see this sort of growing over the next, let's say, over the next couple of years, how do you see this cost, what rate do you see this cost increasing?
- Vamsi Potluri:** Can you repeat the question again, sorry.
- Rohit Balakrishnan:** So basically, sir, I'm asking that so if you look at our cost structure, so we have the numbers that we report, we have employee cost, manufacturing cost, the time would be sort of variable or semi variable. And we have seen other costs, right? So if you look at H1, it's around roughly around INR 60 crores...
- Vamsi Potluri:** Go ahead.
- Rohit Balakrishnan:** Yes. So I'm saying, so just if you sort of take it for the year, maybe around INR 120-odd crores, it will be. So what kind of growth rate do you see for the next couple of years? Just wanted to get a sense.
- Lakshmi Narayana T:** Sure. So in terms in terms of, yes, no. I'll explain you that think you mean to say that how you are reaching out to the expenditure of other employee cost, financial cost and all manufacturing costs like after the getting of gross margins correct?
- Rohit Balakrishnan:** Capacity and increase our volumes. The current cost structure is around INR 120 crores roughly. Now as we ramp up our volumes, what kind of cost increases will you see below our gross margin? So which is around INR 120 crores at the current level on a run rate basis.
- Vamsi Potluri:** I got your point. So I don't think we will see a major increase because I think most of our, like maybe you could see some increase in some manpower and some power cost increase, but not too much. Probably the increase would be 10%, 15%, not more than that in the next two years.
- Moderator:** Thank you. Ladies and gentlemen, due to time constraints, that was the last question for today. I now hand the conference over to Mr. Vamsi Krishna Potluri, for closing comments. Over to you, sir.
- Vamsi Potluri:** Thank you so much for everyone for joining the conference call, and I think we can close the call right now. Thank you.



JTEKT Corporation
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Moderator: Thank you. On behalf of SMS Pharmaceuticals Limited, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.