Management Discussion and Analysis

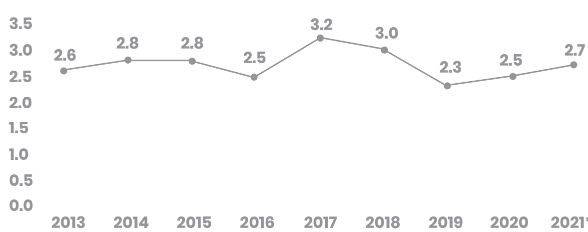
GLOBAL ECONOMY

Due to the advent of COVID-19, which put a stop to a revival after the settling US-China relations and other geopolitical concerns, the global economy has suffered a massive blow. The mystery surrounding the nature and propagation of the virus continues to develop as scientists work hard to decode its biology and find a cure.

The worldwide economic growth was already stunted before lockdowns were initiated in the major countries. The International Monetary Fund (IMF) estimated the global growth to be around 3 percent for 2019, while signaling a worse crisis than the one in 2008-09. This was due to uncertainties surrounding trade policies and sensitive geo-political relationships that disrupted the Chinese economy, as major companies were seeking alternative destinations for manufacturing. Other obscure factors include supply disruptions, tightening of financial markets, haphazard patterns of spending, volatile commodity prices and resulting changes in public behaviour. With export-dependent nations like Germany and Japan inching into recession because of low global demand, more problems are rising.

There is considerable uncertainty around the outlook for global growth. The economic impact depends on factors that function in hard-to-predict ways, including the pandemic mechanism, the strength and efficacy of containment efforts, the magnitude of supply disruptions, the effects of drastic tightening on global financial market conditions, shifts in consumption habits and behavioral changes. Most countries are facing a multi-layered crisis that involves a health scare, domestic economic instability, plummeting global demand, reversal of capital flows and a fall in commodity prices. The chances of having a bad outcome predominate. The only hope is that the pandemic will fade, and the subsequent efforts to get back on track will bear fruit.

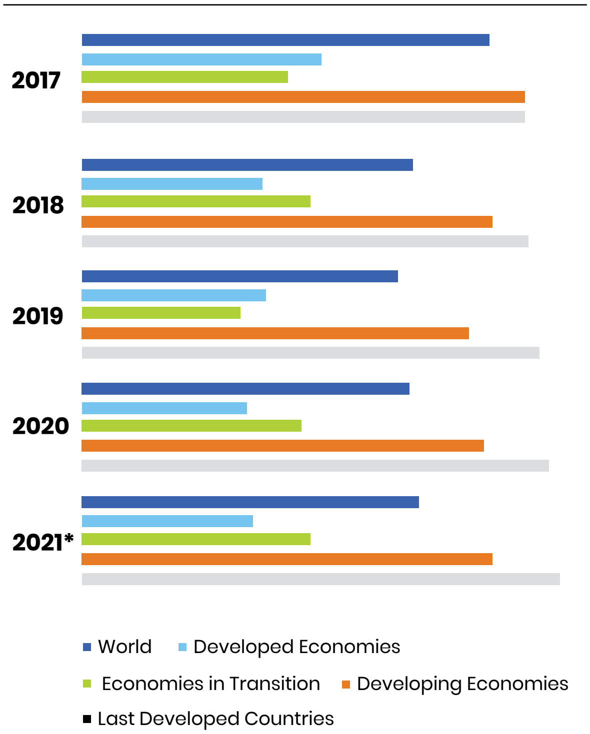
% GROWTH OF WORLD GROSS PRODUCT



In 2019, the world economy has shown its slowest pace across developed and developing regions due to multiple challenges and high risk of uncertainties. The financial year 2020-21 will begin on a cautious note, with numerous industries impacted severely due to COVID-19. With the US presidential elections looming

(Source WESP: World Economic Situation and Prospects) at the latter stage of the year, the world waits with bated breath to discover upcoming developments. The results of the US election will be crucial in driving the global markets. Another important topic is the Price War, which will dictate the oil prices globally. Both Russia and Saudi Arabia are standing their ground, but the damage can be collateral. The war will affect the whole world the longer it sustains.

GROWTH OF WORLD OUTPUT AND GROSS DOMESTIC PRODUCT (%)



INDIAN ECONOMY

For two basic reasons, the ties between India's and the global economy's fortunes are not as strong:

a) we have a large domestic demand base and that supports consumption

b) we are not as reliant on exports as some of the other Asian countries like China and South Korea

It is naive, however, to assume that Indians will remain isolated from global shocks altogether. As for the Indian economy, the return of Prime Minister Modi to power is expected to provide greater political stability and attract investment due to the ruling dispensation's pro-business and pro-reform outlook. Factors such as a reduced interest rate environment and a sharp decline in the corporate tax rate along with limited capacity utilization changes augur well for the currently underinvestment sector.

There are questions, however, and policy makers need to remain cautious. The contribution from the private sector continues to deteriorate, with government spending now accounting for more than a fourth of GDP growth. On top of that, tight fiscal constraints and the recent corona virus outbreak are overhangs. Therefore, the GDP growth of the FY20 may be lower than the 5% YoY CSO estimate. The agricultural production in the recent fiscal was record high, however the economy needs triggers to ensure a sustainable run and fulfil its expectations of a good performance in FY21. High inflation issues won't go away overnight, and higher fiscal deficits could prevent more strong stimulus measures. The consensus, however, is gradually emerging that the worst could be behind us and that India's GDP growth is expected to show a pick up no matter how small it is.

The government continues to remain proactive, and the proof lies in the reported measure showing that the government is recognizing economic conditions and is prepared to act. Significant policy changes have been made in the previous six months to balance both sides of the equation and boost both demand and supply. These include liberalization of FDI requirements for selected sectors; rollback of a much-debated tax surcharge on foreign portfolio investors; opportunities to help multiple industries; restructuring of PSU banks; and significant corporate tax rate reductions. It is anticipated that these steps will strengthen credit growth, increase capital inflows, reinvigorate private investment and hiring, and thus boost economic growth. These essential steps are likely to counter the negative effect of both global and domestic economic factors.

GLOBAL PHARMACEUTICAL INDUSTRY

The global pharmaceutical industry is expected to be valued at USD 1.57 trillion by the year 2023. Despite numerous hurdles, the market is primed for growth in major regions. Aging, medical conditions, rising income levels and increasing populations are crucial factors for consistent progress.

North America continues to be the biggest pharmaceutical market and by 2023 will have the market share of 45.33%. On the other hand, the market share of Europe is anticipated to decline in the coming years and is expected to have 20.24% share. Asia-Pacific continues to be a prominent market for pharmaceuticals and will become the second biggest market globally, with the market share to become 24.07% in a couple of years.

The emerging local pharma companies in Europe, Middle East and majority of Africa will look to buy low-profit generic assets. Most of the drugs sold in Middle East and North Africa (MENA) area are costlier in comparison to major EU countries.

Throughout FY2019, M&A in the pharmaceutical industry continues its promising run in spite of global slowdown in numerous other sectors. The deal values are also set to increase from USD 1.2 trillion to USD 1.5 trillion. With the scenario becoming very competitive, the major players are looking to acquire small and mid-sized organisations for their innovative abilities. Research and development are now a priority as generic pharma are not being re-invented for the masses, limiting growth opportunities. From FY20, pharma companies will lay emphasis on consolidation to keep up with the progress in emerging markets.

INDIAN PHARMACEUTICAL INDUSTRY

The Indian pharmaceutical market and medical device market, respectively, are expected to be valued at USD 100 billion and USD 25 billion by the year 2025. In FY19, the nation exported pharmaceuticals worth USD 19.14 billion and up to January 2020, the number was USD 13.69 billion. The exports consist of drug formulations, bulk drugs, intermediaries, surgical instruments and herbal products. In 2019, the turnover of India's pharmaceutical market was USD 20.03 billion, which was a growth from 9.8% YoY from USD 18.12 billion in FY 2018.

India provides the largest number of generic drugs on a worldwide basis. The country's pharmaceutical sector tends to more than 50% of the world's demand for vaccines, the 40% of demand in the US and 25% of all the medicine in the UK. Over the next five years, the medicine spending in India is anticipated to grow 9-12%, which will bring it to the top 10 tier in this category. Pharma companies in India increased their investment on research and development to 8.5% in FY18 from 5.3% in FY12. On the back of such developments, the healthcare and pharma sector in India is primed for promising growth even as pricing and cost could concern the participants.

The progress of the industry will be supported by the increasing exports to larger and new markets like China, Japan, Indonesia, Latin America and Africa. This will help India in becoming the leading supplier globally in terms of volume, according to Indian Pharmaceutical Alliance (IPA).

The Government of India has taken substantial steps to reduce costs and healthcare expenses. A push to introduce generic drugs into the domestic market continues to be the top priority. Additionally, the emphasis on rural health programmes, preventive vaccines and lifesaving drugs will create multiple opportunities for pharma companies.

COMPANY OVERVIEW:

Aarti Drugs Limited was established in the year 1984 and forms a part of $1000 Million Aarti Group of Industries with a robust R&D Division at Tarapur, Maharashtra Industrial Development Corporation (MIDC) in close vicinity to manufacturing locations. The Company is engaged in the manufacturing of Active Pharmaceutical Ingredients (APIs), Pharma Intermediates and Specialty Chemicals and also manufactures formulations through its wholly owned subsidiary- Pinnacle Life Science Private Limited. Products under APIs includes Ciprofloxacin Hydrochloride, Metronidazole, Metformin HCL, Ketoconazole, Ofloxacin, Diclofenac derivatives etc. whereas Specialty Chemicals includes Benzene Sulphonyl Chloride, Methyl Nicotinate etc.

INTERNAL CONTROL SYSTEMS AND THEIR ADEQUACY:

The Company has a sound and adequate internal control systems commensurate with its size and nature of business. We constantly upgrade our systems for incremental improvements, because we firmly believe that 'change is the only permanent thing'. The Audit Committee of the Board periodically reviews these systems. These systems ensure protection of assets and proper recording of transactions and timely reporting. Internal audit is being carried out by an independent firm of Chartered Accountants on a quarterly basis. The Audit Committee also regularly reviews the periodic reports of the Internal Auditors. Issues raised by Internal Auditors and Statutory Auditors are discussed and addressed by the Audit Committee. Audit Committee constantly tries to add value by evaluating existing systems.

ENVIRONMENT, HEALTH & SAFETY:

The Company is continuously working on innovative technologies to design effective Waste Management Systems. The primary focus of the Company has been on pollution control and clean environment solutions. The Company has drastically reduced the water consumption. Many of the plants of the Company are at zero effluent discharge, achieved through multiple effect evaporators and incinerators. The company has taken 250 acres of forest land from Forest Department for plantation near Dhuktan, Palghar where the plantation work is completed and is maintained regularly. The Company has continuously innovated many more techniques to reduce the effluent generation in the Process, utility and domestic areas across units to reduce the entire effluent stream. Environmental requirements are incorporated into the plant design right from the preliminary stage of a process. Air Scrubbers, Dust Filters, Fire Protection Systems and Effluent Treatment Plants are in place & well maintained. The Company is striving to reach towards the goal of Zero Organic Effluent Discharge by means of multiple effect evaporators and incinerators.

During the year, the Company has conducted various training programmes in all units regarding use and importance of PPE's, Safety Awareness and behavior related to safety. Faculties of Bombay Productivity Council conducted training programme on 'Kaizen' and 'Behavior Based Safety in Organization (Industrial Safety Awareness)'. Training programme on First Aid, Fire Fighting and Rescue Operations in any type of emergency is conducted by faculty of Civil Defense, Central Government Agency for the employees of the Company. All units have Fire Hydrant Systems, all types of Fire Extinguishers, Smoke and Heat Detectors to control the fire hazard. Hydrogen Gas leak detectors and Ammonia Gas leak detectors are installed in our units wherever it is required. In all our units, all electrical fittings are flameproof to avoid fire hazard. Rupture Disc and Safety Valves provided to reaction vessels and distillation units wherever required. Audio Visual Alert Alarm system provided to the reactors wherever there is likely rise in temperature, failure of cooling or chilling system, tripping of agitators. The external Safety Audit as per IS:14489:1998 of all our units which was done by recognised Safety Auditor by Government of Maharashtra. Safety Consultant and Ex – Deputy Director of Department of Industrial Safety and Health has conducted various onsite job training followed by safety related observations. The Company is making continuous efforts to create safer working conditions for the workers.

RESEARCH AND DEVELOPMENT:

The Company's Research & Development (R&D) is recognized by Department of Science and Industrial Research (DSIR), Government of India. It is well-supported by in-house project management team to ensure timely implementation of new products on the commercial scale. We also organize frequent visits of Experts and Professors from Institute of Chemical Technology (ICT) and Council of Scientific and Industrial Research (CSIR) for guidance on product development. In last few years, about 35+ API's (New and Existing) have been developed in lab.

Team work has played a significant role to achieve the financial target which includes one Doctorates, 60 Master Graduates (M. Sc), 15 Graduates (B. Sc) and 35 Engineer Technicians.

SUBSIDIARY:

Pinnacle Life Science Private Limited (PLSPL) is a Wholly owned Subsidiary of Aarti Drugs Limited (ADL). PLSPL was established with a vision of achieving leadership by offering quality and useful pharmaceutical formulations to the World at affordable prices. PLSPL capitalizes the core API strengths of its parent Company and engineers most of the formulations in a cost-effective way. PLSPL contributes around 9.7% of revenue and has opened more avenues of exports for the company.

The company has shown tremendous value addition, through formulation, to existing API products. It started commercial operations in Latin America as well as selective African markets with new registration for export and government tenders. Aarti Drugs Limited and Pinnacle Life Science Private Limited, together present a one stop-shop for major pharmaceutical needs.

During the year, Company has incorporated 2 overseas Subsidiaries and 1 Domestic subsidiary Company. Pinnacle Chile SpA, incorporated in Santiago, Chile, was established for marketing the formulation of drugs and participating in the tender and private market in Chile. Aarti Speciality Chemicals Limited (Wholly Owned Subsidiary), located in Mumbai, India, was founded for carrying on the business of manufacturers, producers, processors, buyers, sellers, importers, exporters and/or otherwise dealers in Speciality and other chemicals, pharmaceuticals and drugs. Pinnacle Life Science LLC is another wholly owned subsidiary of your Company, located in Fujairah at United Arab Emirates (U.A.E.) for expanding business and exploring opportunities in the Middle East and North Africa.

SEGMENT-WISE PERFORMANCE:

For the year 2019-20, around 96% of the total Standalone Sales of the Company came from APIs and its allied Intermediate Segment and approximately 4% from the Specialty Chemicals. Within the API Segment, Antibiotic Therapeutic Category contributes to around 44%, Anti-protozoals around 16%, Anti-inflammatory around 10%, followed by Anti-diabetic, Anti-fungal and Cardioprotectant Therapeutic categories.

FINANCIAL PERFORMANCE:

During FY 2019-20, the company is growing consistently on account of its long-term strategy and robust expansion plan. Due to its global presence with the finest sense of business, it has shown tremendous financial performance.

The top and bottom lines were improved to Rs. 18,061 million and Rs. 1,414 million, achieving a Y-o-Y growth of 15.7% & 57.5% respectively, correspondingly the EBIDTA stands at Rs. 2,678 million as against Rs. 2,135 million in the previous year, recording a growth of 25.4%. Increment in Profit after tax followed by effective costing strategy. Overall gearing ratio reduced to 0.58 times from 0.93 times due to effective working capital management, it proved systematic relationship between Total Equities and Total long-term liabilities reflected through positive changes in the net worth from Rs. 5,434 million to Rs. 6,525 million. Due to environmental issues in China during the last year, there were shortages of raw materials which led to increased input costs. As a Company, we are trying to reduce dependency on imports by the way of backward integration, manufacturing the materials in-house & also developed alternate processes to mitigate the risk of shortages. However, amidst these challenges, the Company was still able to achieve the desired revenue target and also achieving the highest Revenue & PBT till date. With better Working Capital and inventory Management, the Company's overall expenses got reduced, which resulted in the PAT Growth and an improved operating cash flow.

	2020	2019	% Changes
(i) Interest Coverage Ratio	6.2	4.3	44%
(ii) Debt Equity Ratio	0.59	0.91	-35%
(iii) Net Profit Margin (%)	7.79%	5.74%	36%
(iv) Details of any change in Return on Net Worth as compared to the immediately previous financial year along with a detailed explanation thereof.	22.33%	17.54%	27%

(i) The EBITDA of the company grew by 25.5% YoY in FY20 due to better demand and efficient operations. On the other hand, the overall working capital utilization decreased, leading to lower working capital interest. Consequently, the Interest Coverage Ratio improved by 44%.

(ii) Due to lower working capital utilization, the working capital debt of the company reduced whereas the net worth grew substantially due to good PAT in FY20. There was a surplus of Free Cash Flows in FY20, which has helped in reducing our Debt-to-Equity Ratio.

(iii) In FY19, due to the shortage of KSMs from China, we had changed a lot of processes for our products which resulted in lower margins in FY19. After continuous efforts we were able to make these new processes more efficient in FY20, resulting in better Net Profit Margins.

(iv) In FY20, the consolidated PAT of the company grew by more than 57.5% due to better margins and good revenue growth. Additionally, in FY20 the company went for the new tax regime thus lowering the overall tax rate of the company, leading to higher PAT.

IMPACT OF COVID-19:

In the initial days of lockdown in March, the Company's manufacturing activities were impacted to a minimal extent as the majority of the employees could not reach the factory location due to restrictions on the movement of manpower, unavailability of transportation, etc. But, on the basis of the Company's product profile, we were granted permissions to operate the manufacturing facilities, movement of critical workforce, materials, etc. For the safety and security of our employees the Company took initiatives such as social distancing, thermal screening, availability of face masks & sanitizers, awareness campaigns, fumigation, arrangement of Company buses for transportation of staff, sanitation at factories, etc. which gave a boost to the employees' morale and resulted in smooth functioning of the manufacturing activities. Other factors such as the scarcity of logistics facilities, supply and dispatches of raw materials were also affected in the initial stage of lockdown, which has now improved and clocked close to normalcy. As soon as the lockdown commenced, the Company had provided Work from Home facility to the employees of the Mumbai Head Office with necessary connectivity and the Company had ensured that all the IT Security protocols were in place and that all the systems were monitored remotely. The Company has not seen any material impact on the capital & financial resources, profitability and liquidity position and does not foresee any challenge in realizing/recovering its assets as there is no adverse effect on the internal financial reporting and control. However, the Company has implemented stringent control measures across the organization to address any evolving situation resulting from the pandemic. The supply chain is now close to normal and with pharmaceuticals being recognised as essential goods, the Company does not predict any impact on the demand of its products. The Company is well positioned to fulfil its obligations and existing contracts/arrangements. At present, the Company does not foresee any contract/agreements which will have an adverse impact on the business in case of non-fulfilment of obligations by any party.

DISTRIBUTION CHANNELS:

Our strong distribution network has always been a valuable asset for us. This provides us with a competitive advantage and helps us expand to 100+ countries. In most of the cases, we directly send the products to customers via air or sea. This helps us to minimize our costs. In some of the cases where the quantity is not very significant, we ship the products to distributors. We also consciously look for credit quality of our customers and in case we find any credit risk, we execute the transaction via European traders. The Company also has sufficient trade credit insurance to cover risks of receivables.

MATERIAL DEVELOPMENTS IN HUMAN RESOURCES / INDUSTRIAL RELATIONS FRONT INCLUDING NUMBER OF PEOPLE EMPLOYED:

Human capital is an essential part of our Company. The Company has 1536 permanent employees on a consolidated basis. To enhance the capabilities of our most important assets, our Human Resource Development (HRD) Centre has conducted many training programmes during the year. Apart from in-house training programmes, our team has regularly attended many training sessions and seminars at some of the most prestigious training institutes.

OUTLOOK:

The Company has recently expanded its capacity in anti-inflammatory therapeutic category. The Company has also planned capital expenditure for a few more anti-diabetic products in FY20-21 along with intermediate and specialty products. The recent lockdown announced by the government due to COVID-19 has resulted into some production losses due to labour shortage. However, company has managed to sail through these difficult times keeping its production efficiencies around 70-80% due to essential nature of the business. The Company has taken a lot of measures, in consultation with various government bodies, to maintain proper social distancing, arranging for private transport in some cases, regular check-ups, using proper PPE, periodic fumigations for disinfecting premises etc.

Cautionary Statement:

Statement in the Management Discussion and Analysis describing the Company's objectives, projections, expectations and estimates regarding future performance may be "forward looking statements" and are based on the currently available information. The management believes these to be true to the best of its knowledge at the time of preparation of this report. However, these statements are subject to certain future events and uncertainties, which could cause actual results to differ materially from those, which may be indicated in such statements.