"Sequent Scientific Limited Q4 FY-21 Earnings Conference Call"

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Moderator: Ladies and gentlemen good day and welcome to Sequent Scientific Limited's Q4 FY21 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 '*' then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Abhishek. Thank you and over to you sir.

Abhishek Singhal: A very good morning and thank you for joining us today for Sequent Scientific's Earnings conference call for the fourth quarter and full-year ended financial year 2021. Today we have with us Manish, Sequent's Managing Director; Sharat, Joint Managing Director and Tushar, CFO to share the highlights of the business and financials for the quarter.

I hope you have gone through our results release and the quarterly investor presentation which have been uploaded on our website as well as the stock exchange websites. The transcript for this call will be available in a week on the company's website. Please note that today's discussion may be forward-looking in nature and must be viewed in relation to the risks pertaining to our business. After the end of this call, in case you have further questions, please feel free to reach out to the investor relations team. I now hand over the call to Manish to make the opening comments.

Manish Gupta: Thank you Abhishek. Good morning friends and thanks for joining us so early in the morning. A very warm welcome to all of you who have joined us for our Q4 and FY21 earnings call. As Abhishek mentioned, joining me on this call is Sharat Narasapur – our Joint Managing Director. I must apologize on behalf of Tushar Mistry, our CFO who is on this call but will not be able to actively participate. Tushar had a cardiac intervention last week and has joined the call at my request, even though he has been advised rest. He shall be more accessible in about 10 days' time, once the compulsory rest period gets over.

The year gone by has been different for the world as also for the animal health industry in general, but more particularly for Sequent in more than one way.

I will take this opportunity to give a little larger commentary this time, I hope I have that privilege. I would like to start with some thoughts on the industry. Globally animal health industry got distinctly separated from human pharma since about 2013. This trend is now extending to India. Carlyle's investment in Sequent and the recent development around Zydus' animal health business point towards unleashing the potential of Indian animal health companies globally. I would like to believe that this is just the beginning and better days are ahead, as the Indian animal health industry gains traction and attracts more and better talent as well as visibility.

The year gone by has been a landmark year for Sequent in more than one way, as we demonstrated the strength of our unique business model in a very challenging and unpredictable environment caused by the pandemic. Even though we were partly insulated because of the nature of our business or the nature of the industry we are in, COVID did come with significant operational challenges. In addition, there were multiple initiatives at Sequent led by the change of ownership during the first half of the year. We have used this opportunity to build even a stronger framework of governance for sustained growth. We also had extensive engagement with various consultants in the second half of the year to establish a framework for growth or what I would like to call Sequent 2.0.

I am glad to say that the Sequent team overcame the operational challenges, facilitated a smooth ownership transition, including the new and a very diverse Board, and worked with various consultants to chart the way ahead without taking their eyes off the day-to-day operations. None of this would have been possible without the steadfast support of 1,700+ employees across geographies.

At this stage, while I would like to express my gratitude to all the employees for their commitment, I'm also pained that all of this came at a cost, especially during the deadly second wave that hit us hard in India and at Sequent. Two of our employees lost their lives in India with almost 20% of the organization/employees affected, most of them in the second wave. While lives cannot be replaced, both the erstwhile and the new promoters in Sequent, like in Corporate India, rose to the occasion and contributed to the financial and mental wellbeing of the employees. As the reports say, a third wave is expected and I hope and believe that we are better prepared as a country as well as a company to deal with the same. As we speak, 90%+ of our staff in India has received a minimum of one vaccine dose, and it is only a matter of time before everyone in the company gets inoculated.

On the business front; during the year, we commercialized three new APIs and made four VMFs or US filings, taking our total filings to 23 with the US, in addition to our 11 CEP approvals on the API front. We also had our first formulations filing in the key markets of the US, Canada, and Australia. One of the key products launched this year – Tulathromycin, our first formulation development from the Indian R&D center, delivered ahead of our expectations. Our R&D team is working on a strong pipeline of 35+ products under formulations and 8+ molecules for the API business. We also signed a multi-year, multi-product agreement with a large animal health company, marking our foray into the CDMO business. The agreement entails co-investment by them at our Vizag facility and shall contribute to our growth from the calendar year 2023.

As mentioned in our earlier earnings calls, our de-bottlenecking project at Mahad is completed, while the capacity expansion for formulations at our German facility had to be deferred to FY22 due to COVID-related execution challenges. The first phase of Vizag expansion project is now completed and operationalized, while the second phase will be completed in the coming year. This will enable us to deliver on our business requirements, and also maintain the growth momentum in the coming years, even as we aim larger in our next journey.

Our India business has been a key performer during the current year. While we built on our strength in India, we also operationalized a multi-year, multi-product arrangement with Zoetis which was operationalized from 1st July 2020. We also consolidated our minority interest partners in Turkey, Belgium, and the Netherlands during the year, with Brazil to follow during the current year.

Before coming to financial performance, I wanted to bring to your attention that during the financial closing for the year ended March 31st, 2021, the management detected certain instances where revenues in respect of certain sales transactions were recognized on dates earlier to those allowed by the Group's revenue recognition policy, as well as modification of certain underlying documents relating to revenue recognition. The management brought this to the attention of the auditors and audit committee. Under the audit committee's supervision, a detailed review was undertaken and all cases of such non-adherence, wherein revenue recognition was accelerated were identified. The Board has taken findings on the record. The financial implications, though not material, are comprehensively detailed in the note to the results. We have corrected the processes leading to such non-adherence and will continue to strengthen them further and there is no continuing impact.

Further during the year ended March 31st, 2021 the company has reviewed and revised the amounts of foreign currency translation of goodwill arising on the acquisition of foreign subsidiaries. Goodwill arising on such business combinations is translated from the functional currency of respective foreign subsidiaries to INR which was hitherto being translated to the functional currency of the acquiring entity. This adjustment has had no impact on the P&L statement.

Coming to performance for the year:

Our revenues have grown at 15.5% during the year with our formulation business outperforming our overall growth. Formulation business performance in Q4 has been particularly encouraging with key geographies of India, Turkey, and Brazil clocking impressive growth, even as Europe got back on growth track as well. Our EBITDA from operations stood at INR 61 Crores for the quarter, and a little over INR 237 Crores for the year, with operating margins at 17.4% while our net profits stood at INR 95 Crores for the year with a growth of 36%.

With consistent strong cash flow conversion upwards of 70%, we have been able to reduce our net debt significantly, even as we invested in the consolidation of minority interest and CAPEX. We expect this momentum to continue, and we expect to be a debt-free company within the next 2 years, subject to any inorganic opportunities. We continue to place a high priority on the productivity of our capital utilized and are pleased to see our ROCE rise from 7.8% in FY18 to over 20% in FY21. The Board has also recommended a dividend of 25%.

The stable revenue growth, sustainable expansion in margin profile with the continuous reduction in debt has also led to a two-notch rating upgrade during the year. This is a testament to our robust financial performance and resiliency of our unique and sustainable business model.

The company has also rolled out a new ESOP scheme in March 2021 to align the long-term interest of management and employees to the long-term business goals.

I would now like to touch upon what lies ahead of Sequent or Sequent 2.0. Towards the end of Q3, we had engaged with advisors as also our Board to shape up our new enhanced vision and strategy for the next journey. I'm happy to state that we now have an identified path to take which shall largely reflect in the bolder steps that we take as we expand our footprints into the key missing markets of the US, select EU and select Southeast Asian markets; make injectables as our core domain of strength, both in terms of R&D as well as manufacturing; make a foray into the pet business in select markets of India, Turkey, and Brazil; and finally get into complex or value-added generics, leveraging our strong presence in the API business as well.

Towards this expanded vision, we shall be both scaling up our manufacturing footprints with investments in the region of $30 million over the next 24 months spread across all geographies as also strengthening and upscaling our global management team. We shall keep you updated as more talent joins us.

You would appreciate that some of these investments will be significant, keeping a long-term view in mind, and will have a limited impact on business over the next 2 years. We expect to reap the benefits of these initiatives after a couple of years. Therefore, while we continue to guide towards mid-teen revenue growth in the medium term, we shall also be investing and building our organization and governance structure for the larger vision for Sequent 2.0.

As we transition the company towards higher growth and governance trajectory, the Board, the management team, and employees are all committed and excited by this opportunity of creating a true powerhouse in animal health from India.

With this, I now open the session for questions and answers.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Mr. Bharat Sheth from Quest Investment.

Bharat Sheth: Manish your commentary is very-very bullish if one has to really look from 3 to 5 years, because currently whatever you have said that we are investing in somewhat expanding for a bolder step, so if one has to really look at from 3 to 5 years perspective, where would you put our company in absolute vision? So, if you can share and what would be the EBITDA margin currently, if we are investing in building a team and also for a growth opportunity?

Manish Gupta: So, if you look at our past, we have been guiding to mid-teens revenue growth and 150 to 200 bps margin improvement. What we are doing today is that we are taking a break from that in terms of margin expansion, because we are now building up the next level of infrastructure for even faster growth, which will start showing up in the next couple of years. That's the only thing we are changing. I think the revenue growth and the momentum of the business will continue. However, we will use this opportunity to scale our ambitions. While I cannot guide you to numbers because it is a blend of both organic and inorganic initiatives, I can assure you that the next journey will be bolder, will be bigger, and certainly, I believe with better outcomes.

Bharat Sheth: So, when you are talking of high-teen growth we get the mid-teen growth. We can understand but EBITDA, what could be if we are taking a break from 1.5% to 2% expansion which earlier we were looking at. So, will it remain stable, or maybe a gradual improvement, or may decline because of some of the investment which will be in the OPEX nature?

Manish Gupta: I will again look at the longer-term picture rather than getting into a short term of 1 or 2 years because there is an ESOP cost also which is a booking of expenses. It is a non-cash cost. But having said that, where I'm coming from is, the margin expectations of 5 years down the line stays intact or maybe even better than what we had originally forecasted. What we are only suggesting is that in the next 2 years, we are not going to chase margin expansion, but chase capability built up. If it means that margins expand slightly slower or even dip a little, I think that's not the objective that we are focused on. But if we fail to build up the capabilities, I think that will be more disappointing in this journey. So, with the new Board, we have a very articulated direction where we are headed to. Certainly, we need to up-skill and upscale for that vision. It will call for some investments, both in physical infrastructure, but more importantly on the management bandwidth, and have global talent, I think that is what we will be building up. The 5-year journey will be far more exciting is all I can say. But guiding margins for the next 2 years is slightly difficult at this point. It will not be something that will change dramatically, but we are not going to chase margins at the cost of growth.

Bharat Sheth: Now our foray into this pet business in India, Brazil, and Turkey. So, how big is the opportunity really, we see, maybe over little longer-term perspective, 3 to 5 years.

Manish Gupta: So, again, it will be a meaningful opportunity for our scale of business but putting numbers around it is inappropriate at this point of time because it will again be a blend of organic and inorganic initiatives.

Bharat Sheth: One bookkeeping question if Manish you can permit. Of course, Tushar is not there, so I'm not sure whether we have answer but I've been looking at cashflow of full year as well as tax provision whereas cashflow outflow is much higher than the tax provision. So, any color if you can share or we can take it later on from Abhishek or Tushar.

Manish Gupta: I think this question is better answered by Tushar. So, if you can allow us a few days, once Tushar resumes.

Moderator: The next question is from the line of Mr. V. P. Rajesh from Banyan Capital.

V. P. Rajesh: My first question was just on the API side; I am sure you have very little growth in this year. So, if you can just provide a little more color on what's your plan on that side of the business?

Manish Gupta: Rajesh, I am not sure if I got your question right. Can you please ask again?

V. P. Rajesh: My question is regarding the API business. Growth, this year has been very low. I'm just trying to understand how one should think about that piece of the business over the next 3 to 5 years?

Manish Gupta: We were growing at about 18% in the API business in the first three quarters and the growth has been slower in the last quarter. So, all in all, while it is slower than the formulation side of the business it is still a 14% growth in our API business for the year, with some slowdown in Q4. This is largely coming from one product called Albendazole, which is a WHO procurement product as well. There has been a certain slow down for the right reasons because WHO is diverting its investments into other areas at this point. It's a temporary blip in that sense and we do expect us back to mid-teens revenue growth on the API side of the business which is not very different from an overall business growth even for this year.

V. P. Rajesh: My second question is on the one-off expenses that you have listed out. Are you going to have anything which is going to be recurring, especially the consultant line item, the first one?

Manish Gupta: Obviously, the ESOP cost which is a non-cash cost is going to be recurring and that's why we have clearly articulated, this is the 1-month impact. You will have to multiply it by 12 for the first 12 months' impact or FY22 impact. This impact will keep reducing as we go along because of the nature of accounting which is through a Black and Scholes model to be done on this. That is one cost which will certainly stay. I won't say consultant costs, because consultancy was kind of one-off cost or a one-time engagement but there will be certain elements of continuing costs in different forms because you would have seen that we have brought in this concept of an advisory board, and we will be having that as we go along. Some of these costs will continue but it will not be the kind of lumpiness that you saw in this current year.

Moderator: The next question is from the line of Mr. Saket Mehrotra from Tusk Investments.

Saket Mehrotra: The first question is on this Indian market growth for the full year. We have seen almost a 100% increase. Is it because of say the rearrangement with some of our partners or did we start tapping into newer opportunity? So, any color on this and what can be a sustainable rate going forward?

Manish Gupta: Certainly, if you look at our Indian market performance, a part of this growth is coming from our commercialization of Zoetis portfolio and part is coming from our business performance. I would kind of split it 50-50 between the two. Certainly, as we go along, while the growth will taper, we do expect to maintain fairly rapid growth in the India business even going forward.

Saket Mehrotra: The second question is on this strategic advisory board that you have got. You have put a slide on that on slide #7 of your Investor Presentation. Any more details you would want to give on this what is the thought process behind this?

Manish Gupta: If you look at the last part of our deck which is about Sequent 2.0 you will see that fundamentally, we are transforming in this next journey from a branded generics animal health player to a specialty branded generics animal health players and to that extent, we will need to bring in people who have those kinds of capabilities, connects, knowledge about this industry. We have to see the future. As a generic company, we are a backward-looking company. When I say that, it is about existing products and creating demand or replacing demand. We are now moving in a direction of creating demand and that requires people with very different mindsets and this entire advisory board is to fill up those capabilities for us. Does that make sense Saket?

Saket Mehrotra: Yes, it does.

Moderator: The next question is from the line of Mr. Rushabh from Pravin Ratilal Shares.

Rushabh: Just one question on the steep devaluation of Turkish Lira that has happened in Turkey and we have close to 15% of our revenue coming from Turkey. Does it at all affect financial statements in this period and the coming periods?

Manish Gupta: Not at all. The way we operate in Turkey is that we keep adjusting our price list after a couple of months based on how the currency behaves. We tend to keep an eye on that and keep revising our price list. So, there is no sustainable impact. You will see that our Turkish business is performing very well. It continues to perform ahead of our expectations, and it serves as a good opportunity for scale companies like us because these kinds of devaluations impact the smaller players in the country more and allows the larger players to gain a larger market share.

Rushabh: But we do have our receipts in US dollars only, or is it in Lira? I mean the kind of sales we do in Turkey? Just wanted to understand the business front of it.

Manish Gupta: Everything in Turkey is done in Turkish Lira. The sales are in Turkish Lira. Most of the expenses are in the Turkish Lira. A small part of expenses that relates to the API purchases from outside Turkey will of course be in foreign currency. To that extent, there will be certain exposure but through a blend of exports and also, I mean regular financial monitoring those are fairly well contained.

Rushabh: Just one question on slightly longer-term outlook. 2 years back I even read con-calls of Sequent Scientific and there you used to guide that by 2022 we would have a return on capital of close to 20% and somewhat the management has walked the talk. Like going down the line presently we are a 1300 Crores top line company. As and when we grow to a 2000-2500 top line Crores company; would we see a net profit of close to 500 crores which is like a 15%-20% sort of a margin going down the line 5 years. Some sort of guidance if you can give on that front.

Manish Gupta: I cannot see that long future honestly as we know the journey; we know the curve we are chasing. Financial outcomes are best determined by people who are closer to this. Our job is to stay focused on business. I can assure you that the curve going ahead will be steeper in terms of outcomes, but I would refrain from giving any guidance around numbers.

Rushabh: Just a small bookkeeping question if I could squeeze in. Our other expenses for the Quarter 4 of FY21 have risen quite substantially. Last quarter we had some 65-66 crores and it's now almost (+10) crores. What is this component which has led to the increase in these other expenses?

Manish Gupta: I think that is explained in that EBITDA bridge because we hired consultants and engaged them on various initiatives. So, slide #11 of the investor deck will explain that. Other than the ESOP cost which would have gone into the employee cost all others would have gone into other expenses.

Moderator: The next question is from the line of Mr. Devan from Family Office.

Devan: This advisory board that you have now constituted and then the appointment of a consultant. It does appear that you have bitten off more than what you can chew and you are really struggling for skills. This is something beginning very unwieldy for you. You are refraining from giving any guidance which is all right but it really does appear that you are floundering in terms of managing the acquisitions. Can you give me some insight into this?

Manish Gupta: I don't know what gave you that impression that we are floundering and that's why we are seeking help. What we are seeking is technical guidance around the industry, around its future. This is not execution guidance. It's all about getting multiple perspectives around the future of this industry. This is transitioning from a branded generic model to a specialty branded generic model. I don't think it's about taking help for execution; it's about co-creating a larger framework for the way forward.

Devan: No having an advisory board and a consultant and in the same time you are also talking about upskilling and upscaling. These are all kind of counter intuitive, can you explain what do you mean by when you say this up-skilling, what is the upskilling that Sequent is looking for?

Manish Gupta: When you get into specialty generics, can the same R&D team deliver? The answer is probably no. We need to bring in the next level of capabilities. What is happening at Sequent is with the change of promoters we are establishing a new vision for ourselves. It is not that we are continuing the same vision. We are now upscaling the vision and upscaling a vision also calls for upscaling of the skill sets of the organization and that's what we are building as part of this journey. Carlyle is looking to upfront the investments in the first 2 years because only then being in a pharmaceutical equivalent industry it takes 3 to 5 years for your investments to start paying off. That's what we are doing. I cannot take away the impression you may be having but it is a very well-thought-out initiative that has been taken. These advisors are, brought in to help us co-create the vision because it's not a very well-documented industry. You have to bear that in mind.

Devan: That's the reason why I thought that this is giving that kind of an impression that it is very difficult to manage. Anyway, now I understand where you are coming from. The other question that I wanted to understand from you is, are there any regulatory changes that are happening in the market that Sequent is operating in, which possibly will require the company to reorient its strategy?

Manish Gupta: Not really, our industry is extremely and fairly regulated in line with human pharma. I don't see any changes happening in that regard.

Devan: Let me clarify. I might have given an impression; I am not talking about Sequent and the business that Sequent is operating in. I am talking about the customers that Sequent has. Are there any regulatory changes that is impacting the animal industry and is that going to have any impact?

Manish Gupta: Again, I don't think regulatory changes are happening but there are directional changes that may be happening and that is why I was referring to this entire thing of specialty generics or how the industry is going to transform over the next couple of years. That's the preparedness we are working towards. It is not regulatory; it is about customer preferences and every industry undergoes that.

Moderator: The next question is from the line of Mr. Prasad, an individual investor.

Prasad Hazariwala: I would like to know how much ESOP impact there are in next year in FY22?

Manish Gupta: If you will multiply the number that has been disclosed into 12 would be broadly the impact for the current year.

Prasad Hazariwala: It is coming around 60 to 65 crores that is what will be the impact?

Manish Gupta: Yes.

Prasad Hazariwala: You said we cannot increase EBITDA, operating margin. It will be around 15% to 17% tentatively? We can take it like that? Last year we have done 17% right. We can consider this into 17% will be maintained for next 2 years?

Manish Gupta: Don't hold me to it but I think it should be more or less there.

Moderator: The next question is from the line of Mr. Vipin Sharma, an individual investor.

Vipin: My name is Vipin. I was wondering if you could provide any colors on the US-CDMO deal that we have signed. Maybe the size of the deal or whether it can impact top-line materially?

Manish Gupta: Certainly, it is material for our API business. I am assuming you are referring to the CDMO, is this the particular deal you referred to?

Vipin: The CDMO multi-year, multi-product deal.

Manish Gupta: It is both a CDMO and also a product supply business covering about two products on the CDMO side and six products on the product supply side which is our existing products. Certainly, it is going to be relevant for our API business and that's why we are guiding towards the mid-teens revenue growth even on the API side of our business. It will start contributing meaningfully from calendar year ‘23 but does it make a huge difference at a corporate level? The answer will be yes but limited.

Vipin: My second question is the foray into the pet market that we have and do you still know whether we are only targeting India, Brazil, and Turkey market or do we also have a strategic vision for targeting the US, Europe, and developed markets there for our pet products?

Manish Gupta: I will respond to this in two buckets. In Europe, we already have a pet business. In that market we operate in, we sell both large animal and pet products. If you look at the real differentiator of Sequent it is our three key markets of Brazil, India, and Turkey which are high growth markets with their own unique set of challenges. That's where now we are getting into building our existing business by getting into the pet business. Our US strategy, currently we are building up a portfolio of pet products, but we have not looked at how we will commercialize and that is something which we will probably look into as we get closer to the commercialization. In a nutshell, we certainly have a pet strategy at the back end of it, but purely from a US angle, we do not have an articulated commercialization strategy whether we will do it through partners or on our own.

Moderator: The next question is from the line of Mr. Hardik Bora from Union Mutual Fund.

Hardik Bora: **Congratulations on achieving 20% ROCE mark.** Actually, my network was weak, and I missed the line on the guidance. I think you are refraining from giving any guidance for the next year but just as far the long-term roadmap was laid out by Sequent a while ago that 5 years, or 3-4 years down the line that does not materially change right as far as the revenue and the profitability trajectory is concerned. Just wanted to have your views on that.

Manish Gupta: Hardik, what we are seeing is, historically we have been guiding towards mid-teen revenue growth and a margin expansion of 150 bps year-on-year. What we are changing is that we are no longer guiding to margin expansion in the short run because we are building up costs for upscaling and upskilling for the next wave of the journey. We continue to maintain our revenue growth for the medium term. We do expect revenue growth to accelerate in the latter part of the tenure but for that, we need to build up cost and that's why we are not giving any margin expansion guidance. That is the only change we are doing. Just to add one more thing but overall, we expect that Sequent 2025 should be bigger and better than the earlier vision that we had for the company.

Hardik Bora: If I may follow up on this, till what year do you expect that these costs will typically hit the profits before contributing to the top line? So, should one expect this near-term pressure to be there for 2 years 3 years, if you could give me that idea?

Manish Gupta: Don't expect pressure. It is just that we are taking out the expansion guidance. We are not saying that margins will start dipping or those kinds of things; we are saying that expansion is no longer what we are chasing; we would rather invest and build up a better future. This will be typically for the next 18 months' time, not longer than that.

Hardik Bora: Understood on that part. One is on the balance sheet, so we still have some shares of the side group Solara now, so just wondering if there's any plan on reducing that also selling that stake as well?

Manish Gupta: We have always maintained that this is treasury investment for us and as and when needed, based on the guidance of the Board, we will look at monetizing it for the right reasons, but it is in a way growth capital for us.

Moderator: The next question is from the line of Rishabh from Edelweiss.

Rishabh: What are your plans for the US in terms of inorganic growth, have you started looking out for a possible target or the company plans to build its own portfolio organically there?

Manish Gupta: Rishabh, I don't think I could understand the question very clearly, but I did understand that you were referring to something around inorganic growth. Now inorganic growth – certainly Sequent has grown inorganically, even in the past, and we are always open to inorganic opportunities. Today we do have access to a wider network through the Carlyle system for evaluating or seeking inorganic opportunities. It's ongoing, very difficult to set any targets around it because we are not going to chase many targets around inorganic, we are chasing strategic opportunities as far as filling some of the missing gaps in our portfolio, either in capability or in the market. So, inorganic will be always a bit opportunistic in that sense.

Rishabh: I'm asking what are the plans for the US, specifically in terms of growth drivers like are we planning to grow our portfolio organically there?

Manish Gupta: Yes, certainly we are going to grow our portfolio organically without a doubt. Having said that, we are also open to inorganic opportunities for the US because that will only help us accelerate our growth plans for the country.

Moderator: The next question is from the line of Arpit Shah from Stallion Asset.

Arpit Shah: Just have a couple of questions, just wanted to confirm ESOP cost would be 60 crores?

Manish Gupta: Yes.

Arpit Shah: Earlier EBITDA for 220 crores so the ESOP cost will be closed to 60 crores, would that be an impact?

Manish Gupta: It depends on how you look at it because mathematically it's a non-cash cost, first I want to highlight. Second is if you understand the way the model works, it is a reducing kind of number, the highest impact is in year one and then it keeps coming down. Yes, the first year in fact will be 60 crores, it'll keep going down as we go along probably go down to 60% of that, and then 40 and 20 that's the way it works. Having said that, I think it's an investment for the future which is what I mean shareholders had approved this and that's how this has been kind of accounted for. Does that answer your question, or you have anything specific to ask?

Arpit Shah: Last time last quarter we spoke a lot about China. How are we planning to enter China Carlyle as a system for there but this time you're not saying anything pertaining to China be it with consultants with advisory councils? So, what are the strategies in China?

Manish Gupta: See China obviously is a very important animal health market and as I mentioned earlier, we are relying on the Carlyle network and expertise as far as that market is concerned. Having said that, given the geopolitical situation we are waiting for things to settle down before we start looking East.

Arpit Shah: I just wanted to understand the business profile for CDMO, what is the return ratio, specifically over there, and what could be our revenue mix going forward next 3 to 4 years?

Manish Gupta: I don't think I'll be able to give you that granular information. It is highly proprietary, so please forgive us for that.

Arpit Shah: If you can just answer is it with the US-based innovator company?

Manish Gupta: See again we are bound by confidentiality on that, but it is very easy to get there. Not many innovative companies, so see CDMO has to be with the innovator company and there are not many in this space.

Moderator: The next question is from the line of Rajat Srivastava from InCred Asset Management.

Rajat Srivastava: My question is around the CDMO business again, just wanted to check whether are we going to use our existing facilities for this or we are going to do some incremental CAPEX and create a new block for this business?

Manish Gupta: The current work is being done from the current setup, but if you look at our investor presentation, we will be working on creating something specific as well. Not for this business, but as an overall CDMO capability on the investor deck slide 24 captures that a dedicated CDMO unit will be created within our current infrastructure at Vizag. When we say CDMO, it's the same but it is more flexible.

Rajat Srivastava: So, for this multi-year deal we don't need to do any CAPEX?

Manish Gupta: If you see the multi-year deal includes a co-investment proposal by the company.

Rajat Srivastava: Could you also put some light on the current capacity utilization?

Manish Gupta: This is always a difficult question because capacity is also a reflection of your planning or inefficient planning. Having said that, in the pharmaceutical business or the kind of business we are in you always build capacities ahead of the demand, and which is what we continuously do. If you ask me technically, I don't need if I have to do or if I don't need to choose growth after 2 years, I don't need to invest at all. But all our CAPEX is that we are talking of again on slide 24 is all about looking at a 5-year vision and creating those capacities ahead of the curve.

Moderator: The next question is from the line of Hardik Shah from Prabhudas Lilladher.

Hardik Shah: In a previous investor presentation the 9-month profitability was around 855 million and currently we've profitability is 950 million, but still Quarter 4 PAT is around 200 million. I'm not able to understand what the difference this?

Tushar Mistry: Hardik, you may just refer to note #14 of the results that we have published and refer to that there'll be clarity in that.

Moderator: The next question is from the line of Jigar Valia from OHM Group.

Jigar Valia: My question pertains to Turkey. Turkish Lira has seen significant depreciation not just against USD but even against INR over these many years now and businesses is growing, we've even expanded capacity. I want a perspective on export opportunities from outside of Turkey and at what point in time it becomes a more viable or a better option along with the export from India?

Manish Gupta: So Turkey is a jewel in our crown in a way, given the unique geopolitical location and also some of the strong entry barriers that country has. It is an injectable business. Another development is now the facility is approved by the EU authorities. We will be looking in this next phase on the Turkey business as a far more strategic business from a global perspective in this next wave of the journey, and with the consolidation of minority stake that we have done recently in Turkey, we will have a complete say in the proceedings going forward and we will be developing our Turkish operations not only for Turkey but also for our emerging markets and Europe. I believe a lot of this currency risk will therefore be tackled through that.

Jigar Valia: So, other question is if you can help understand the opportunities and a strategy for Canada and Australia.

Manish Gupta: As of now we are looking at Canada and Australia opportunistically. They are important markets in animal health, specifically Australia, and what we are doing is only leveraging our current portfolio for those markets. But as we go along, we probably may develop a distinct strategy for those markets as well. But right now, it is just an adjunct strategy of commercializing the existing portfolio that we are developing for the regulated markets in those markets through partners.

Jigar Valia: How big would Australia be or can be for us, can it be like double digit numbers?

Manish Gupta: I would right now say we have not looked at it that way but my guess is you allow us some time. We have plenty of things to be achieved in the next 12 to 18 months. We'll look at Australia and Canada in the phase thereafter.

Jigar Valia: Last question from my side with regards to CDMO, are we looking at just new molecules or are we also actively targeting site transfers etc.?

Manish Gupta: So, site transfer technically comes under CMO business. So, far, we have not chased the CMO business, having said that if there is a good value proposition, we can look at it. Again, the bigger focus is on getting into CDMO rather than CMO at this point.

Moderator: The next question is from the line of Karthikeyan VK from Suyash Advisors.

Karthikeyan VK: A couple of things could you give some timelines for the German injectable facility targeting the US markets and the filing timelines?

Manish Gupta: We have already made our first filing for the US and more will follow. Commercialization will take time because FDA approval has to happen and the current scenario is not so good in terms of inspections; our Germany facility is yet to be inspected, so difficult to give a timeline for approvals but the portfolio is under build-up.

Karthikeyan VK: Second is slightly broader question; given your own track record in terms of very cost-effective acquisitions and attractive valuation of Sequent stock, is the company looking for a slightly more aggressive strategy?

Manish Gupta: I think that it is definitely what we are going to see, with the change of promoters and the new Board, certainly will help us kind of increase our risk profile in the right way. I do foresee that we will be a little more aggressive without being foolish about it.

Karthikeyan VK: Stock swap – is it a part of your M&A plan, is that the way you think about it?

Manish Gupta: I don't have any such mandate from the Board.

Moderator: The next question is from the line of Aakash Manghani from BOI Axa Mutual Fund.

Aakash Manghani: Earlier on the first question is, you highlighted that over the next 24 months there will be some 200 Crores sort of investment, can you help me understand how much within API and formulation?

Manish Gupta: You're referring to capital investment or you're referring to the skill investment?

Aakash Manghani: No, the CAPEX.

Manish Gupta: The CAPEX my guess would be about 25% towards API and the remainder would be towards formulation.

Aakash Manghani: You highlighted in one of your slides that you're moving up the value in the formulations towards more of the specialized pharma. So, currently, I'm assuming you don't do much of specialize pharma. So over the next 3 to 4 years want to build out this portfolio. What sales mix within formulation would that have and what margin profile do these specialized generics operate, how much higher would it be due to current margin profile where we will build the portfolio?

Manish Gupta: Again, I stay away from guiding on this front but I think that explains the difference between the margins of the innovator companies versus the generic company. I think there is a fairly large Delta between the two and our move towards specialty products will kind of help us bridge some of those gaps. So, that's broad guidance I can give you but more specific will be not appropriate from a strategic and proprietary perspective.

Aakash Manghani: So, these specialized generics would be in existing geography which is Brazil, Turkey and India or you are looking at US as well, this is part of US plan or next few years?

Manish Gupta: The specialized products which I'm referring to are more towards the US and European kind of markets and less towards India and Brazil, Turkey kind of markets.

Aakash Manghani: Is there a ROCE threshold that you can talk of over the next 3 to 5 years, you are making so many investments, probably they will start payoffs in 2-3 years from now. Can we start looking in the range of 30% once these investments start to payoff, margin profile moves up with better growth, any comments on that?

Manish Gupta: So, again, while I can't guide you to numbers because a lot of strategies has to still play out, but the vision is to keep improving the ROCE at the same time not shying away from investments if it means a dip in ROCE in the short run. Because I think that 20% ROCE from a 7.5% 3 years back, we have achieved a fairly good outcome. As somebody said, we walk the talk and somebody said we partly walk the talk, but we did walk the talk in some way or the other. We are very pleased with that outcome but that is not going to be a determinant for all our investments. We are happy to sacrifice some ROCEs in the short run if it has a big delta for us in the long run and that's the Board and the promoter mandate for us. Having said that, these decisions are always taken at a Board level after considerable deliberations.

Moderator: This was the last question; I would now like to hand the conference over to Mr. Manish Gupta for closing comments.

Manish Gupta: Thank you very much for your questions and we hope we have been able to answer most of your queries. As we close fiscal '21, the key message from our side is that Sequent's business model is unique and a well-diversified business model. With the new promoters that we now have, we are further building on our financial and management bandwidth to add more growth engines to the same. Successful organizations across the world have been built on the back of exemplary teams and sound systems, and we are proceeding in that direction by hiring the best of talent from global corporations as well as engaging consultants to provide the right frameworks for both strategies as well as processes. These investments as you can imagine will reflect the increased cost in the short to medium term. Before I conclude, I would like to commend the employees of Sequent, who rose to the occasion in these very trying times and the whole success of what we have built today is solely because of their efforts and commitment. Thank you once again and we can now close the call.

Moderator: Thank you very much. On behalf of Sequent Scientific Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.