Q3 & 9M FY17

Results Conference Call Transcript
February 10, 2017

Siddharth Rangnekar Good afternoon ladies and gentlemen. Welcome to Laurus Labs Limited's or Laurus' first conference call for investors and analysts. The call has been hosted to discuss the financial performance and share operating highlights of the Company with you.

I have with me on the call– Dr. Satyanarayana Chava – Chief Executive Officer and V V Ravi Kumar, Executive Director & Chief Financial Officer. We will commence the call with comments from the management team, post which we shall open the call for a Q&A session, where the management will be very glad to respond to any queries you may have.

At this point I would like to highlight that some of the statements that may be made or discussed on the conference call may be forward looking statements. The actual results may vary significantly from the forward looking statements made. A detailed statement in this regard is available in Laurus' 9M&Q3 FY17 result presentation which has been circulated earlier.

I would now like to invite Dr. Satya to commence by sharing his thoughts on the listing of the Company and on the strategic progress made by the Company thus far.

Dr. Satya Chava Good afternoon and thank you for joining us on the very first investor call since listing in December 2016. We enjoyed good support and good wishes from the investors as a listed company. Personally, and on behalf of Board of Directors and management would like to express our appreciation to investors for their continued support.

Laurus has delivered a robust performance in the 9 months of the current financial year in the Q3 of the current financial year recording a revenue growth of 10% and 12% respectively. This is in line with our inherent strengths, of the model what we developed about a decade. This is first approach that is bringing out sustainable and profitable growth.

Laurus Labs is one of the foremost research and development driven pharmaceutical companies in the country with 25% of the colleagues working in R&D, that is the one of the highest in the country. Since inception around a decade ago, we have been putting research first approach that was truly along us to differentiate from the peers. As on March 31st, 2006 our expenditure and R&D stood at 5% of the revenue, a trend we always see it, that is mentioned. And in the first few months of our existence we emphasized exclusively on developing

research base to APIs manufacturing. Out of these efforts we did very well in the broad therapeutic areas interestingly Oncology, anti retrovirals, Hepatitis C and other therapeutic areas like antidiabetic. Today we have about 600 scientists across Hyderabad and Boston, in the United States.

Over the past couple of years, the Company has spent about 5% of our revenue on research consistently. The objective being two-fold. The one is first to identify the new generic opportunities where we could make a difference and the second is to improve our existing manufacturing efficiencies. So, our research development is naturally our modern regulatory compliance. Moreover, one unique distinction our company is following same manufacturing standards across all facilities to achieve standardized quality irrespective to the markets where we are offering. I would say this is the hallmark of our approach and to remain same and committed to upholding and even exceeding the standards as many regulatory agencies demand.

Let me give you some perspective on the business and how we operate. We have four divisions within the organizations. Generic APIs, by far the largest division and we have 4 facilities at Vizag where we produce, ARV, Hepatitis C, Oncology, cardiovascular and antiasthma apart from other therapeutic sectors. The combined reactor volume in these facilities is around 2,000 cubic meter. Post-acquisition of Sriam Labs we also got additional 330 cubic meter reactor volume put together this is one of the top 5 largest chemical manufacturing segments. We also have another division Laurus Synthesis where we focus servicing NCE, clinical phase molecules as well as custom manufacturing for already genericised molecules under the long-term contract and obligations.

And the third segment is Laurus Ingredients where we make out of our Vizag facilities nature identical dietary supplements and cosmeceutical ingredients we make. This business is also a very unique; we give the same standard like pharmaceutical standards to the dietary supplementary as well.

The segment where we entered late to fuel our growth is our Laurus Generics finished dosage forms where we engage ourselves of manufacturing of formulations oral solids right now. It would be marketed by our partners as well as we have a clear intention to do our front end in various markets. We have several molecular developments in ARV, diabetic, cardiovascular and Hepatitis C areas. A dedicated facility is commissioned at Vizag for this regard.

In the leadership profile, you see today is the effort we put over a decade to bring best talent available in the industry to take advantage of our regulatory complaint facilities. And we also have a long-standing relationship with our customers. We have people, facilities, and products and also very important to note our relationship with our customers is also very long standing. We are driven by a strong research motive where our strategy to expand the change and scope of our present operations guided by few factors. One of the critical thing is want to capitalize our leadership position in APIs especially in the therapeutic areas like the antiretroviral, cardiovascular, diabetic, Oncology these being our focus areas we are continuously creating capacities to cater to the growth in this markets.

We are also putting lot of emphasis on expanding our portfolio of APIs, either we make for our needs, or market our need to contract manufacturing for other generic companies. As a step towards forward integration we also invested significantly into oral solid formulations. This will become our major stream of business going forward, to deliver not only revenue but also improved margins. Why people are very happy to look at us as a forward integration in the finished dosage forms, so

we eliminate several complexities of sourcing APIs and sourcing formulations. So they will be also benefited from quality relativity and consistency of products and operations. As of end of Q3 FY'17 we have two ANDA's filed in the United States and one dossier with WHO and we have concluded four validations in the quarter ending this December 2017 fiscal.

Synthesis business is also very interesting for us. We can offer our chemistry skills to our customers. We support several clinical phase programs and we also do exclusive contract manufacturing agreements with our customers. Once specific example is, we created a dedicated facility for Aspen to do steroidal intermediates and hormonal intermediates. These are under very long term contracts. At present substantial portion of the business comes from contract manufacturing to specific customers and rest of the business comes from supplies of pre-clinical based APIs and we see significant growth in these areas because several products are on the phase 3 and about to be commissioned.

In the Ingredients business, we are also expanding not only from nature identical ingredients to natural extracts as well. We have few products, but few products we are supplying to the globally renewed customers in dietary supplements and cosmetic segment. We believe there is opportunity for us to play a much bigger role in the space of reaching large number of patients in diabetic, cardiovascular and antiretroviral and Hepatitis C and this is also demonstrated by our leadership position in especially in HIV and Hepatitis C.

Going forward our growth will also come from, the revenue increase coming from capacity expansions, improvement of margins coming from manufacturing efficiencies and the new product introductions. Gains will also come from our forward integration into formulations and also from Synthesis business as we move from early phase to later phases and also commercial but this is also very significant. What is also important is growth is always underlined by our healthy balance sheet and also cash flow generation.

With this I would like to hand over to Ravi, who will walk you through the key highlights of the financial performance.

V.V. Ravikumar

Thank you Doctor. Good afternoon to everyone. I warmly welcome you all for Laurus maiden earnings call. It was launched into the public space by way of IPO was a stepping stone for Laurus. As we know we have an opportunity to share our unique business proportion with much wider audition with the hope that we can part of success story which we believe we continue to derive substantially. Dr. Satya has given you a deep insight into the evolution of our business. I will share the key highlights of our growth story.

I will share our results performance for the quarter and the first 9 months of the current fiscal. Let me share with you all the results performance of the first 9 months of FY'17, total revenue we improved by 10% whereas our EBITDA has increased by 23% and our PAT was increased by 40% for the first 9 months' time. Whereas our 9 months our revenue increased by 12%, our EBITDA 10% and PAT is 18%. So, this is the performance of the 9 months and the 3 months' time.

Let me give you a broad overview of the CAPEX initiatives over the next few years. The companies enhanced capacities in R&D what we have done is we have expanded our R&D capacity in Hyderabad and we are also creating an R&D capacity in Vishakhapatnam. The Company enhanced capacities in R&D and its manufacturing expertise of key products of unique strength plans to leverage to

grow our new business. The company is currently in investment phase across key businesses especially in finished dosage form. In the generic FDF business over the past two years we have invested more than Rs. 2 billion to set up one million tablet capacity per year. As we grow, we thought of expanding of this capacity and we already initiated the capacity expansion to 5 billion which we expect to be before March '17. We also incurred, we are making huge investments because we already filed two ANDAs and four validations we completed. For this we have spent about a Rs. 821 million in the first 9 months' time. So this is an investment we made for the formulation business. The expansion progress is on schedule. We have already placed orders; of course we have completed this before end of this March.

The Company continues its growth plan in all our business segments we will continue to make prudent investments. This includes investment in a formulation facility, Synthesis business, and Ingredient business and also in capacity expansion in the API business at an appropriate time. It is important to know that most of the CAPEX would be financed through internal accruals. So we expect leverage remaining stable, the return ratio will continue to improve, despite the company being in expanding mode.

I would like to reiterate that we have taken several measures to tap the next level of growth. We see promising growth in FDF business, Synthesis and ingredients as well as outlined earlier and which are currently at a nascent stage that provide a very attractive opportunities as we go ahead. Our core focus will continue to be on our quality, technology, research and world class manufacturing as tread on our path to become a leading player in offering integrated solutions to global pharmaceutical needs. The expansion of volumes in the generic API business is expected to drive robust cash generation by being a lever for margin expansion. Similarly, the growth of business comprising of Synthesis and FDF is also expected to substantially enhance contribution levels, based on these factors we are hopeful of delivering an improved year-on-year performance for the next few quarters.

With that I conclude my opening remarks and request the operator to open the forum for questions.

Moderator Thank you very much. Ladies and gentlemen, we will now begin with the question and answer session. We have the first question from the line of Bino Pathiparambil from SBICAP Securities Ltd. Please go ahead.

Bino Pathiparambil Just wanted to understand how you look at the growth we have seen in the first 9 months, Q4 is typically a bigger quarter, are we looking at a better growth for the full year and how does top line look forward into FY'18?

Dr. Satya Chava As we mentioned earlier, we are not giving any guidance for future quarter as well as the future year, but we can tell you, you could see from the investor presentation what we presented to all of you. Our gross margin is expanding; our EBITDA percentage on revenues is expanding. As we move forward we generate revenues from the new facilities in synthesis as well as in finished dosage forms. The margin expansion will be very substantial, the reason being as Ravi mentioned we have incurred Rs. 821 million on finished dosage forms opex as well as R&D, any revenue generation with significant gross margin will improve our financial performance both top line as well as bottom line significantly.

Bino Pathiparambil Got it. What are the product launches in pipeline for FY'18? New products?

Dr. Satya Chava In APIs we are having significant products in gastroenterology-proton pump inhibitors, anti-diabetic we have few product launches; we also have few product launches plan in anti-retroviral segment as well. One key product we launch in next year is part of the licensing agreement we got from Gilead as part of Epclusa, Velpatasvir and Sofosbuvir. We expect to launch API next year for the domestic market.

Bino Pathiparambil Right. Would this product from Gilead, when you launch that, would that cannibalize into the existing, Sofosbuvir sales or do you expect a growth and also if you could take me through the ARV-API launches for Europe and US, what is it looking like?

Dr. Satya Chava We are planning to launch Velpatasvir which is sold in combination with Sofosbuvir. So Velpatasvir launch will not cannibalize Sofosbuvir, rather it will increase off take in this Sofosbuvir. The difference between the combination products on the market and the new combination products which will be launched soon, it is pan-genotypic, means Hepatitis C patients from genotype 1-6 can use the Velpatasvir combination for a short duration versus genotype 1 and 3 patients can use Sofosbuvir and Ledipasvir combination. So we expect market expansion may happen without cannibalizing Sofosbuvir sales. That is on the Hepatitis C. And in the ARV front, we are planning to focus on second line API launches. So far as a company we will focus more on first line APIs. We are planning to focus also on the second line APIs: Ritonavir, Lopinavir, Atazanavir, and Darunavir for emerging markets and also we are at the right time to capture opportunities for sale of some of these ARVS into European and US markets.

Bino Pathiparambil Right. I was just wondering what the status there is. I believe we have partnership with front end companies with Europe and US. So are we expecting Europe sales to contribute FY'18 or US to FY'19?

Dr. Satya Chava Some of the revenues will be realized in FY'17 itself. So, we supplied part of the launch quantities and we expect to supply little more to allow them to gear up for full launch quantities.

Moderator Thank you. We have the next question from the line of Anurag Mantry from Jefferies India Pvt. Ltd. Please go ahead.

Anurag Mantry Firstly if you can just help me with revenue split that is given in the PPT. From that the sense that we are basically getting is that in this quarter the Hepatitis C and the Oncology revenue is much below the run rate seen in the first half of this fiscal. So can you just throw some color on that?

Dr. Satya Chava Anurag, your question is pertaining to the Hepatitis C sales in Q3, when compared to the nine months' sales, is that the question?

Anurag Mantry Right. So the phase of Hepatitis C and Oncology both when I compare the third quarter sales versus the first half sales, it seems that both these have reported substantially lower growth rates.

Dr. Satya Chava You are right. In Hepatitis C we had sales to partner in the previous quarter and we expect that will be improved during this quarter. So there is nothing substantial decrease and we are very comfortable in that segment as well as Oncology. Oncology is a natural thing. We are not looking it as an aberration in our sales. That is one reason we are not giving quarterly or yearly. So, with the business you

cannot see on a quarterly basis. We do not see any significant concern in Hepatitis C off take as well as in Oncology off take.

Anurag Mantry Sir secondly if you can just help us with the 3Q FY'16 revenue split as well, in to basically Hepatitis C, Oncology, FDF etc.?

Dr. Satya Chava FY'16 we have not given that number, but we can…

Anurag Mantry Just to do a Y-o-Y comparison, so that if there is any seasonality we can basically you know…

Dr. Satya Chava Actually Hepatitis C was bigger than last year we can tell you. We do not have the exact numbers. It is bigger than last year. Oncology is very similar.

Anurag Mantry You mentioned you are not giving any guidance, but any sense on how basically for the fourth quarter how are your revenues and how your margins are kind of shaping up in comparison with the rest of the year because it seems that there might be some element of seasonality or a larger quarter expected in Q4, is that a correct observation? Is the fourth quarter typically a larger quarter in terms of performance of both revenues and margins?

Dr. Satya Chava See, if you see our 9 months FY'16, FY'17 EBITDA margin improved by almost 240 basis points, whereas in Q3 FY'16 to Q3 FY'17 is almost flat, 22.6 to 22.1 When you compare the Q4 versus the last 9 months we expect EBITDA will, definitely will improve little bit better than the 22.1 what we have reported and revenue also we will be better than Q3 what we have reported.

V.V. Ravikumar And of course the another question what you asked on the Hepatitis C we have done more than the full year number of FY'16 in the nine months' time on that basis here. But on Oncology side, which is slightly lower side when compared to the year but we will do a lot of Oncology sale in the fourth quarter.

Anurag Mantry So I mean if I, based on the 9 month numbers that you gave out, if I just derive the fourth quarter FY'16 sales and EBITDA numbers, it seems that the EBITDA margin was close to 25% in Q4 FY'16, is that correct or are there any reference to that based on IndAS and would you expect a similar kind of a range for the full quarter this year?

V.V. Ravikumar We do not want to comment on this. Sorry.

Moderator Thank you. We have the next question from the line of Abhinav Ganesha from Canararobeco AMC. Please go ahead.

Abhinav Ganesha I had couple of question. First one being Sir, we are not having any 483 presently If you could give some color on that?

Dr.Satya Chava We have no pending 483 right now.

Abhinav Ganesha That was helpful. Sir second one is one of the CRAMs players in generic space in your vicinity has got serious kind of 483, so do you believe that some material business impact happened to them and some of the API and CRAMs can shift to you?

Dr. Satya Chava No. See, these businesses are very long sustainable businesses and it is too early to comment. People whoever gets adverse comments from FDA they work very diligently to overcome. It is too early to comment on the outcomes and it is also very early to comment if any business will overflow from one company to another company. It all depends on the pre-approval process and all. It is very unlikely that business will flow in a short time.

Abhinav Ganesha One last question Sir. This NATCO, you are having a good tie up. So if NATCO does the Copaxone which they will do for Mylan, the marketing they are having, so are we supplying any API for that?

Dr. Satya Chava Copaxone API we do not supply.

Moderator Thank you. We have the next question from the line of Gagan Thareja from Kotak Mahindra Capital Co. Ltd. Please go ahead.

Gagan Thareja My first question pertains to your ARV business. If I look at the numbers given in the DRHP, for the first half of this financial year, you reported 772.2 metric tonnes of ARV APIs, versus last year full year 1,597.3 metric tonnes. So if I annualize 772, given that it is unlikely that Q4 is going to be a very huge quarter, then what that means is that essentially the tonnage supply of ARV APIs this year might not be more than last year or at best equal to, or marginally higher. So I just wanted to understand that given the outlook that you give for ARVs in your DRHP where you are talking of API demand from 2015 to 2018 growing at almost 17% for EFV and 28% for FTC and almost 20% for Tenofovir. Why is year to date metric tonne sales growth not sort of matching or tying up to the demand forecast that you have?

Dr. Satya Chava See, we are expecting some additional approvals for some of the APIs and the volume growth will happen as and when the new approvals are obtained by our partners and also as I mentioned in one of the question, we are also working on second line ARV APIs that will strengthen our position in the ARVs much better than what we have today.

Gagan Thareja Specifically for Tenofovir and Emtricitabine your first half reported volumes are, if you analyze them would fall short of last year's volumes. Is it the case that in Tenofovir and Emtricitabine you might have lost some share in the ARV space?

Dr. Satya Chava No, in the Efavirenz we added few customers.

Gagan Thareja That is Tenofovir in India?

Dr. Satya Chava No, Tenofovir also will do very well. Emtricitabine is only sold to South Africa we haven't lost customers but we didn't gain any customers. So the Efavirenz, Tenofovir volumes will improve better than the last year whereas Emtricitabine may stay flat.

Gagan Thareja So, what could be the sustainable growth rate be in the first line treatment of Efavirenz, TDF and Emtricitabine, just to be able to have some idea of how this market can grow for you?

Dr. Satya Chava I said 10% growth in Efavirenz and Tenofovir, not significant growth in Emtricitabine whereas growth will be there for Lamivudine for which we are starting commercial manufacturing soon.

Gagan Thareja And how do you perceive the development of Dolutegravir and its combination, to materialize and scale over a time period and do you also see us in positioning for APIs there?

Dr. Satya Chava We have validated Dolutegravir, we have filed DMF. We are perfectly placed. Any opportunity for Dolutegravir we are going to capture. So we are not a weak position in Dolutegravir, but at a good position in Dolutegravir as well.

Gagan Thareja Purely on cost comparison is Dolutegravir comparable to the current first line of treatment cost wise or is there a vast differential yet between the two?

Dr. Satya Chava As of now there is no market shift or no new market created for Dolutegravir and every regulator, every manufacturer is watching carefully how Dolutegravir off take will happen and if so how fast it will grow and which countries will approve as a first line, which countries approve as second line, what is the fate of Dolutegravir in TB patients, pregnant women and children. So there are several unanswered issues on Dolutegravir. People are watching carefully and right now there is no tender floated for Dolutegravir anywhere in the emerging market.

Gagan Thareja But from a medical standpoint the tolerance of Dolutegravir in patients tends to be better especially from psychological impact of Efavirenz vis-à-vis Dolutegravir. So is it not a viable case that Dolutegravir would therefore be potentially good substitute to the current level of treatment.

Dr. Satya Chava On theory, but it all depends on the regulatory framework each country will follow. What WHO, PEPFAR and other agencies will recommend and everybody is watching carefully as I mentioned Dolutegravir will pave the way for the new therapy in ARV.

Gagan Thareja My second question pertains to the Oncology, again going back to your DRHP numbers, first half 2017 volumes is 3.1 metric tonnes compared to 4.46 for the full year last year. If I annualized 3 it goes to 6 for the full year, so there is a volume growth happening, but it does not seem to translate into value growth. So which would mean that on an average the API prices would have seen some significant erosion. So am I correct in my inference there?

Dr. Satya Chava Oncology, the volumes we cannot extrapolate. See Oncology the API prices vary significantly from tens of thousands of dollars a kilo to few hundred dollars a kilo. So this volume growth may not translate into value growth in Oncology.

Gagan Thareja How much would have been the volume growth year-to-date nine months in Oncology for you?

Dr. Satya Chava Actually in Oncology or any other segment maybe you should talk about value growth rather than just volume growth. The prices are so widely different in Oncology from $300 a kilo to $30,000 a kilo, so we cannot compare the volume growth versus value growth.

Gagan Thareja So basically your volume is largely coming from Imatinib and Gemcitabine, if I understand correctly.

Dr. Satya Chava You are right.

Gagan Thareja So have you seen API prices in Imatinib and Gemcitabine?

Dr. Satya Chava We can tell you very clearly. On both Gemcitabine and Imatinib there is no price pressure. There is no margin contraction there.

Gagan Thareja Then I am sort of unable why value growth does not follow the same line as volume growth follows in Oncology. I mean, if the two major contributors are not seeing generic price erosions or rather price erosion in API prices and volume off take has increased, then that should not be the case.

Dr. Satya Chava Broadly I can tell you. We take Imatinib for domestic market, is about $350 a kilo whereas Gemcitabine for export markets is $5,000 a kilo. So it is 1:15 ratio, if we sell 15 kg more of Imatinib sell one kg of Gemcitabine both are equal.

Gagan Thareja Okay. So Imatinib you sell only in the domestic market?

Dr. Satya Chava We also sell in the regulated one, because that is not big.

Gagan Thareja I understand. One more question is on the Hepatitis C portfolio. If we look at the commentary of NATCO in Hepatitis C therapy, interestingly they seem to indicate that this year they have sort of reach to a sales level from where scale up might be very gradual between flat lining to gradual. On the other hand, obviously, in theory the potential for growth seems to be significantly higher, also as pointed out by your DRHP. So I am sort of unable to reconcile why NATCO gives a guidance of rather moderate-to-flat growth in Hepatitis C from here on vis-à-vis what theoretical potential seems to be?

Dr. Satya Chava See, the difference between ARV and Hepatitis C is, the ARV people take it life long, whereas Hepatitis C, the emergence of a patient and a patient cured within 12 weeks. So growth maybe as they mentioned could be marginal in Hepatitis C and after the new product launch, the Epclusa generic in India, there could be uptake in the volumes after the growth will be very marginal unless the new markets, other than India, the approvals are obtained even then it will be single-digit or lower-teen growth rather than high percentage of growth.

Gagan Thareja But given the fact that out of more than WHO sales there are 12 to 18 million patients with Hepatitis C in India and the treated patients up to last year are only 2,80,000 so there is a huge potential to ramp up. I understand the cost of diagnosis involved, these could be hurdles but the penetration rates for the treatment can go up significantly and if the market potential is as high as that then why the thought process that growth might at best be a single digit to moderately low double digit number?

Dr. Satya Chava See, all Hepatitis C infected patients they don't need treatment on the day one. So that is the reason. So when they need the treatment depends on the market growth. That means, all infected patients sometimes they do not need even treatment.

Gagan Thareja So out of that pool of 12 million, theoretically 12 million patients inflicted with Hepatitis C what is the potential pool of patients which would require treatment?

Dr. Satya Chava It all depends on the disease progression, we cannot say percentage wise, that is the reason the growth is marginal. Once a million patients are treated then those million patients do not need Hepatitis C treatment further. A new patient arises only when disease progress happens and when they will go see a doctor for complications. So then they go for treatment. See in emerging economies there is

no comprehensive Hepatitis C screening for the people. So unlike in other countries, that is the difference in the emerging economies.

Gagan Thareja So even if, you and NATCO go ahead into countries with large Hepatitis C patient pools like maybe in Indonesia or Vietnam or Egypt you do not see that impacting the sales growth trajectory materially for you.

Dr. Satya Chava It will impact but it is marginal. So the growth will not be significant. It will sustain. The business sustainability is very long. The growth may not be significant.

Moderator Thank you. We have the next question from the line of Chirag Talati from Kotak Securities Limited. Please go ahead.

Chirag Talati Firstly, I am looking at your quarterly performance and it seems that broadly in terms of the percentage split of revenues it is in line with what we saw even in FY'16, so I was just wondering why have gross margins come off on a Q-o-Q basis or given that actually ARV is slightly lower perhaps this quarter in percentage of sales terms.

V.V. Ravikumar It is because of the product mix, Chirag.

Chirag Talati But then ARVs should be lower product mix. If it goes down your gross margins should actually go up a bit?

V.V. Ravikumar True. But it is only because of the product mix. If we look at in other APIs, first 9 months is Rs. 93 crore and 3 months is Rs. 47 crore, it is most like close. So Oncology is lower side if you look at Rs. 840 crore minus Rs. 190 crore. So lower Oncology contributed to a lower gross margin.

Chirag Talati And is there anything unusual this year in terms of seasonality or should be also typically, if I look at your half year it seems like the 48 to 52 split between first half to second half. So, should we also expect this year to be the same, there should not be much divergence from that trend.

V.V. Ravikumar We hope to follow the trend in Hepatitis C.

Chirag Talati Yes. One question on the South African tender which will probably come up this November-December for the next 3 years. Given that nobody has yet received an approval for Dolutegravir, do you actually believe that it will even be included in the South African tender or there is a high probability that Dolutegravir will not be included in the upcoming South African tender.

Dr. Satya Chava Chirag, it is too early to predict what will happen.

Moderator Thank you. We have the next question from the line of Sangameswar Iyer from Subhkam Capital Ventures Pvt. Ltd. Please go ahead.

Sangameswar Iyer Sir just wanted to understand, the potential from Metformin for next financial year and on the Aspen deal what is the kind of ramp up that you are expecting, since you have already commercialized. What is the kind of ramp up that you are looking at for the next financial year? Could you throw some light on both?

Dr. Satya Chava We filed our DMF, we filed our ANDA for Metformin. Our ramp up in Metformin sales will be based on our ANDA approval which we expect to get in the last

quarter of next financial year. We will keep you posted on the development. We haven't heard from FDA about the target action date for Metformin. Once we receive that we can tell you clearly how much ramp up will happen, actually it is not ramp up, the sales will start for Metformin depending on the ANDA approval date.

Sangameswar Iyer From the Aspen deal could you throw some light in terms of what is the kind of potential that you are looking. I know you have mentioned that it will ramp up slowly, but in terms of revenue potential could you throw some light on that?

Dr. Satya Chava The new unit which we inaugurated in November, we started validations. For next 15 months, we expect to finish all the validation batches and then the commercial sales will start.

V.V. Ravikumar Actually then it will be in recovery of fixed cost. So for whatever we have incurred till November as a fixed cost that is going to be recovered from the customer.

Sangameswar Iyer Actually even if we do some kind of revenue say Rs. 60 crore – Rs. 70 crore that would be predominantly as a recovery for the fiscal that would…?

Dr. Satya Chava The fixed cost and billing of validation batches.

Sangameswar Iyer So Sir, just want to understand, I mean it is a question that Chirag also asked earlier. When we look at our gross margin for the first 3 quarters, they have been constantly coming down because if I am not wrong, currently it is at around 40. I am talking at the gross margin level. It is currently at around 45%?

Dr. Satya Chava Broadly yes.

Sangameswar Iyer Which in Q1 was at around 49% I think that was the number that we shared earlier.

Dr. Satya Chava We did not share anything.

Sangam Iyer So what I am trying to understand here is, going forward how should one be looking at the margin profile because Aspen deal also whatever revenue contribution comes in it is not going to contribute to the EBITDA, so effectively there would be an optical dip in the margin as well. So to offset that do we have any lever per se for the next financial year that one should be looking at, that will help us in some sort of an expansion in margins?

V.V. Ravikumar Only in the third quarter there is a dip in the gross margin, that is due to the less Oncology sales and then even that will be restored in the fourth quarter and also like recovery of fixed expenses from the Aspen Unit 5 and few of the ARV launch in the European markets also will take place in this quarter. So we expect in margin, by all means would need to go up.

Sangameswar Iyer Okay. ARV as a mix when we look at it, would you result in gross margin expansion because Oncology revival definitely would give us some expansion in gross margins but ARV sales in Europe would that also lead to margin expansion or would it lead to sustenance of the margins.

V.V. Ravikumar Gross margin expansion, it will allow.

Sangameswar Iyer And Sir on the interest cost. I mean, in the presentation you had mentioned that we have done a repayment of Rs. 226-odd crore, but sequentially if I look at the

interest cost that has gone up from Rs. 25-odd crore to Rs. 29.5- 30 odd crore. So could you throw some light in terms of, is there any one-off in that interest component that you are looking at here?

V.V. Ravikumar No, the interest component, it has a 54E also there. This is on account of the foreign exchange. So otherwise interest cost has come down when compared to the year-on-year.

Sangameswar Iyer So how much is the foreign exchange component, I just missed that, sorry.

V.V. Ravikumar The interest component will come down and then in the fourth quarter, whatever be the repayment we have done, we have done in the fag-end of December. So on the entire Rs. 225 crore we would be saving around 11% interest in the fourth quarter.

Sangameswar Iyer And any, you had mentioned some FOREX component in this interest. Could you just throw that, some light on that?

V.V. Ravikumar If it is on the interest cost arbitrage, if you are doing a dollar billing and because of the mark-to-market you need to incur an additional cost, that will be put it in the interest cost. I do not think from where you are talking, it is higher interest cost in the Q3, but another thing is we also made any payment for prepayment penalty of one our loans. It happened in the one-off cost in the quarter 3.

Sangameswar Iyer How much was it?

V.V. Ravikumar Prepayment finalities is about a Rs. crore.

Sangameswar Iyer And what should be the effective tax that one should be looking at going forward?

V.V. Ravikumar Effective tax is going to be, current year I can say is about 20%-21%.

Moderator Thank you. We have the next question from the line of Duby Rex from iThought Financial. Please go ahead.

Duby Rex Is it basically possible to get some revenue numbers in terms of the geography?

V.V. Ravikumar We have a direct export of around 40% and the third-party export that means we sell it in the Indian market but in term of customer manufacture itself in the international market. That is another 45% and 15% is the domestic market.

Duby Rex And how much would USA approximately be? How much that earning would be approximately?

Dr. Satya Chava May be 10%.

Duby Rex Okay and the bulk could be from Europe, is it?

Dr. Satya Chava The bulk will be for African market, the anti-retrovirals.

Moderator Thank you. We have the next question from the line of C. Srihari from PCS Securities Limited. Please go ahead.

C. Srihari Firstly on the dosages from can you please tell us what was the incremental CAPEX on the expansion from one million to 5 million tablets and secondly what would be the optimal turnover, turnover at optimal capacity and I gather Metformin is one of the filings, can you please tell me what is the other filing?

Dr. Satya Chava We have done two filings, Metformin and Tenofovir from the site and before products validations were done already. I think we will tell you before it as and when we file the ANDA. Incremental CAPEX we are doing close to Rs. 8 billion. With incremental CAPEX, the capacity will go from 1 billion to 5 billion tablets.

V.V. Ravikumar Maybe I want to put it in, your third question in a different way. So today if you look at about Rs. 400 crore of assets which are not yielding any revenue, including the expansion for formulation, so I want to leave it to you calculation, suppose even if you take fixed asset turnover ratio of 1 or 1.25, that should be the additional revenue we can generate once we start utilizing these assets.

C. Srihari Yes. I think that fairly answers it. On the Synthesis front can you please let us know how projects you are working on currently and what is the breakdown in terms of Phase-I, II and IIII?

Dr. Satya Chava Synthesis business we have about 25 programs currently active. 4 is the Phase-III and 3 in Phase-II and rest of them are in pre-clinical Phase-I or Phase-IIA.

C. Srihari So these four, are any in any late stage Phase-III clinical trials?

Dr. Satya Chava One is in late Phase-III. We supplied, I would say, late Phase-III as well as launch quantities already for one program. Rest of the programs we are about to conclude Phase-III supplies. So it will take reasonable time for them to do Phase-III compile data NDA and all.

C. Srihari So this is an Oncological product, I believe Sir.

Dr. Satya Chava Already what we have supplied is not Oncology.

C. Srihari Can you let us know the therapy?

Dr. Satya Chava It is Cardiovascular.

Moderator Thank you. We have the next question from the line of Manushi Shah from Research Delta Advisors. Please go ahead.

Manushi Shah I had one question, that the four validations that you talked about, so are these products patent protected or you need to have Para IV filings for the rest?

Dr. Satya Chava Last four product validations were completed are not yet genericized.

Manushi Shah So they are patent protected?

Dr. Satya Chava Yes. We can only give you that information, nothing beyond right now.

Manushi Shah Alright, just one more on that Oncology NCE, is that for US market?

Dr. Satya Chava It is for global market.

Manushi Shah So it includes US?

Dr. Satya Chava Yes, absolutely, it includes US, Europe all.

Manushi Shah And what stage it is in?

Dr. Satya Chava The Oncology supply agreement what we signed is in, so we will go to Phase-III.

Moderator Thank you. We have the next question from the line of Gagan Thareja from Kotak Mahindra Capital Co. Ltd. Please go ahead.

Gagan Thareja Could you give us the details on your inventory days and receivables outstanding for the current period?

V.V. Ravikumar Our receivables are about 120 days.

Gagan Thareja Is that how you will probably end the year with or there could be marked change from that?

V.V. Ravikumar Yes, that is a normal trend. It goes to 90 to 120.

Gagan Thareja And inventory?

V.V. Ravikumar Inventory anywhere between 180-200, 180 days.

Gagan Thareja And just one more question on your tie up with Citron for formulation filings in US. If I understand it correctly Citron possibly is under investigation by DoJ for significant price increase issues that were raised in US recently. Does that in any way impact your possibilities in US in any circumstances in the future?

Dr. Satya Chava We do not expect it will not have an impact on our business. The products are different.

Gagan Thareja No, I am simply sort of trying to understand, if the outcome of the DoJ case go say against some of these companies which has been implicated. Could the fall out possibly mean that partnership launches might in someway get impacted because of that or you feel that is too far-fetched?

Dr. Satya Chava I think it is too early to predict outcome and also we know what is available in public domain, other than that we do not know anything on that investigation.

Gagan Thareja And tax rates you indicated this year could anyway 20%-21% but subsequent to that in the following year, how should we think of the tax rates for your company?

V.V. Ravikumar Maybe in subsequent years may be initially it will be around that range but only question is the DSR benefit will be reduced to 150% from next year onwards and the only thing is we have our formulation facilities in SEZ. Once we start generating revenue and profits from that unit probably the tax rate will change.

Moderator Thank you. We have the next question from the line of Anurag Mantry from Jefferies India Pvt. Ltd. Please go ahead.

Anurag Mantry I missed your comments on your Aspen deal that you made in terms of the expenses that you incurred and the revenue contribution that is probably come in later. So if you can just highlight that once more and if you had any quantification and if you could just release the numbers?

Dr. Satya Chava We are not quantifying revenue right now, but what we can tell you, what we informed already, the facility started operations from last week of November and for the first 15 months we expect to do only validations there. Until such time we complete validations start selling commercial, the billing will be facility billing and the sale of validation products.

Moderator Thank you. We have the next question from the line of Sangameswar Iyer from Subhkam Capital Ventures Pvt. Ltd. Please go ahead.

Karan This is Karan from Subhkam. Can you just give us a layout of your CAPEX plans for the next 3 years?

Dr. Satya Chava What we anticipate of CAPEX will be in the range of Rs. 250 crore-300 crore for the next 3 years, each year.

V.V. Ravikumar Sir, it is a plan, it is not sacrosanct, but it is estimation.

Karan Sir would be majorly for formulation facility or existing in order to increase the capacity of existing API facilities?

Dr. Satya Chava It is intermediates, APIs and finished dosage forms. In all 3 segments put together.

Karan Sir can you just given absolute number of inventory, debtors, and creditors, as of December 2016?

V.V. Ravikumar We said inventory is about 180 days, receivable is 120 days.

Karan Sir absolute number in figures?

V.V. Ravikumar Absolute number I do not have at this moment.

Moderator Thank you. Ladies and gentlemen, that was the last question. I will now hand the conference back to the management for the closing comments. Thank you and over to you.

V.V. Ravikumar Thank you. I hope we have been able to answer all your questions. If you have any further questions or would like to know more about the company, we would be happy to be of assistance. We hope to have your valuable support on a continued basis as we move ahead. On behalf of the management I once again thank you for taking time to join us in the call. For further queries, please do write to us through our investor relations mail ID which is in our website. Thank you everyone. Thank you very much.

Moderator Thank you very much. Ladies and gentlemen, on behalf of Laurus Lab that concludes this conference. Thank you for joining us.