Earnings Conference Call
Q3 FY15

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MANAGEMENT: **MR. ARUN KUMAR – FOUNDER & GROUP CEO**
MR. BADREE KOMANDUR – CHIEF FINANCIAL OFFICER

MODERATOR: **MR. ABHISHEK SINGHAL – ANALYST, MACQUARIE CAPITAL SECURITIES INDIA PRIVATE LIMITED**

Moderator: Ladies and Gentlemen, Good Day and Welcome to the Strides Arcolab Q3 FY15 Earnings Conference Call hosted by Macquarie Capital Securities. As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Abhishek Singhal of Macquarie Capital Securities. Thank you. And over to you, sir.

Abhishek Singhal: Thanks, again. Good Afternoon, all. Welcome to the Strides Third Quarter FY15 Results Earnings Call. We have with us the senior management of Strides. I will hand over the call to Mr. Arun Kumar — the Founder and CEO of the company to make opening comments and then possibly we can open it for the Q&A session. Over to you, sir.

Arun Kumar: Thank you, Abhishek for hosting us. Good Evening, everybody. Appreciate your time today on the call. So we announced the results today; we had revenues from continuing businesses growing at 19% from Rs.273 crores to Rs.326 crores; Quarter-on-quarter there has been a 11% sequential quarter growth from Rs.293 crores to Rs.326 crores; EBITDA at Rs.66 crores came in at 20% and this been a good robust number considering that we have not accounted for profit share for Vancomycin. For those of you who have been following the company, we have quarter EBITDA run rate of close to Rs.9 crores or Rs.90 million. This quarter we only accounted for about Re.1 crore as our profits. This is because we are reconciling our charge-backs and returns for the last couple of quarters and there seems to be some more time that was required for this exercise to be completed. So being prudent we decided not to add these numbers till we have the final audited numbers coming our way. The fact that we have been continuing to maintain our market share and pricing, we think this is a one-off event, and we should either be able to pull back this profits during this quarter or this may be just a one-time event. So we are currently evaluating those implications and like I said we wanted to be prudent and we have not accounted for that. R&D cost this quarter has almost doubled, momentum increasing simply with more filings; we had four filings in the quarter, so we have now got to a kind of momentum there with our new R&D center now fully operational. Adjusting for the Vancomycin, we would have reported, a normalized EBITDA would have been about Rs.74 crores, that is an EBITDA margin of 22%, but what we have reported is Rs.66 crores with an EBITDA margin of 20%. Similarly, our PAT would have been about Rs.48 crores and EPS about Rs.8 per share, this is after absorbing our Biotech expenses and our 9-month Pharma EBITDA with normalized Profit Share is about Rs.193-194 crores with an EBITDA margin of about 22%.

So it is going on track; things are working well, our businesses are going steady, we have had two product launches this quarter**,** and one product approval and we expect the Calcitriol launch to have a positive impact this quarter. We are also hoping to receive a few more key approvals during the course of the next couple of months and hopefully we should get to a good size.

And we are obviously looking forward to the integration with Shasun which would make us a fully integrated pharmaceutical player in the near-term and our updates there are that we have already received the 'No Objection' from the stock exchanges, we are awaiting the CCI and FIPB approvals on the Shasun merger, we filed our applications to the High Courts and we expect directions from the Bombay High Court to shareholders in the near-term, whereas in Madras, the directions to convene the 'Shareholders Meeting' has already been notified last week. So we are progressing well there.

The other positive point in this quarter is that our institutional business is tracking well. The growth from Rs.81 crores to Rs.128 crores is predominantly driven by Antimalarial, and this is the first full quarter where we had a good malarial business and we hope to continue the momentum there. Regulated business has been flat primarily because of Vancomycin, and emerging markets has also been flat because in Q2 we have had a very strong Africa performance which has been offset this year by an improved domestic performance in India with the Raricap acquisition from Bafna, now very well integrated and we are now running a run rate of Rs.3 crores a month on that product, and that is what is bumping up the emerging markets. So we believe that all our businesses are tracking well to strategy.

The other major event during the quarter was our licensing agreement with Gilead's Sovaldi, in the drugs and the hepatitis C range including the new investigational pan-genomatic type drug. We are expecting that we should be in a position to commercialize Sovaldi sometimes towards the end of the next financial year, and we are working in full speed to achieve that. That in short is the highlights for the quarter, and I will be more than delighted to answer any special questions; I have with me my colleague Badree, our Group CFO, who will be happy to address any questions relating to balance sheet or P&L or any other matters relating to the financial parts of the business. Thank you.

Hitesh Mahida: [Antique Stock Broking] First thing on the regulated market business, even if we were to say reduce that Rs.8 crores from Vancomycin, still our sales were slightly down quarter-on-quarter. So is there some impact because we are changing our business model we are taking products from partners and now we are selling it on our own, we have seen IMS numbers, we are now selling Ergocalciferol with our own marketing team, then Mycophenolate, so some of the products we have started selling it on our own during the quarter, and do we expect this business to scale up going ahead?

Arun Kumar: Except for Vancomycin all the products that have been approved in the US are now marketed under the Strides livery. Obviously, it takes some time for us to get traction and contracts. There has been significant bidding; almost 30% of the US Generics business is being bid during this quarter. So we are expecting new contracts to come our way. So it will take us time and this is a conscious decision to move away from a partnering model to front end products ourselves. But we are seeing traction month-on-month if you look at gross IMS, we are now getting close to about a million dollars in gross sales on our own livery which was less than $200,000 six to eight months ago, but that is still not enough, it needs to scale up significantly higher, and I think with all these new product launches and new product approvals and including pipeline product approvals, we should get to a good size. Regulated markets has also been impacted especially in Australia because of exchange rate. Our Australian business, we have had 5% to 6% impact on the AUD in the last quarter. That has also impacted our top line. So we have price adjustments based on exchange rate and stuff like that, but all that there is a lag for it to happen. So yes, you are right, regulated market has been flat or even if you add Vancoymcin has been almost steady state. We do not see this as a worrying signal, it is just that is the evolution of the business and it takes a little time to ramp up, and we are very confident we will get to the right numbers very soon.

Hitesh Mahida: [Antique Stock Broking] Second thing on the emerging market business, despite the integration of Raricap during the quarter, our business is down sequentially. So, what could be the reason behind it?

Arun Kumar: It is down sequentially only by a crore of rupees. Q2FY15, we had a significant business out of our Namibian operations, which was very significant, which is not happening every quarter, we have a long-term contract for the Namibian facility, so we do have peaks and valleys around that, it is a new plant, it just went commercial six months ago. So we had a very strong Q2FY15, out of Namibia. That was not there, but it was made up by increased domestic sales on Raricap**.**

Hitesh Mahida: This institutional business which we have seen a 58% quarter-on-quarter growth, the offtake is higher in one quarter, second quarter it is lower. So, do you expect this Malaria business to continue even in next quarter or we will witness …?

Arun Kumar: Malarial business is going through a new process of procurement. So we are not very sure if this is going to be very consistent, we probably need one or two quarters before we understand where we stand on this, but our belief is that we would do fairly consistent quarter-on-quarter on the Institutional business at these levels.

Hitesh Mahida: This Oral Vancomycin, it was a very good product for us, we were doing Rs.9 crores EBITDA as you rightly said, so now it is down to Re.1 crore this quarter, and Lupin also has entered the market today itself. So do you expect this Rs.9 crores run rate to come down significantly or how do you see this?

Arun Kumar: The market for Vancomycin Oral in the number of units is growing; we have 54% of the market with our partner, and the only other partner is about 30% that is Akorn which is a Cipla product, and you rightly know. I think with Lupin getting an approval there would definitely be a shift in the market share, but I do not think the impact would be very significant, because although there are five players, five approved generics, as you know, two of us have 80 to 85% of the market, so it will take some time for newer players to get market share, but we respect and appreciate Lupin's ability to take market share, so we believe that our market share will not drop dramatically, but it will be stable, and I think this Re.1 crore is not something we should read too deep into it, it is a one-off simply because the reconciliation is going on and I do not think we should read too much beyond this one quarter event on this product.

Anil Shah: [Birla Mutual Fund] Just wanted to understand, how would you look at a little bit down the road, let us say in 2017 where you have the new product that we tied up with Gilead you said, the end of next financial year, we will start working on that in terms of shipments and obviously by then we should also Shasun consolidated with us, so how would the total picture of Strides in 2017 look like?

Arun Kumar: We are waiting the merger to be officially completed, we expect to conduct an investor day just immediately a week after that, when we can give you a better guidance on where we are going ahead this time. Until the merger is improved, we cannot speculate or give you guidance on future, what things look like in 2017.

Anil Shah: [Birla Mutual Fund] The next question is more on the lines of our own products. Across the industry we have not seen approvals coming through in a quick succession from the US FDA. At our end, while we have received some, are you satisfied, and how do you see that shaping up? Over the last three quarters, our run rate on EBITDA has been kind of flattish, Rs.60-65 crores, when do you start seeing an uptick there?

Arun Kumar: If you look at it, EBITDA does not necessarily mean flattish, it has moved from Rs.50 crores to an adjusted number of Rs.70 crores in two quarters. So in our view that is a significant growth from where we were last year on this business. I think the incremental growth will come with the synergies coming from the Shasun transaction and the portfolio maximization process that will come through by the end of 2017. So, at this stage we believe that we have achieved run rate of close to Rs.300 crores on our core business, we think we can take that a little more, maybe Rs.350 to 400 crores with the pipeline that we expect approvals and stuff like that, that is a very healthy number in terms of percentages, cash flow, and size. Added to the Shasun business it should add up to a very important number in terms of total generic play. So as a company is concerned, I am actually quite pleased with the progress that we are making with our business. "Would we have loved more approvals quicker?" "Yes, of course." Every company would say that. We are seeing a lot better traction; we got three or four product approvals in the last 90 days. So we do not have too many files pending with the FDA. So considering that we are quite happy with the fact that our approvals are coming faster than our filings, because we wholly commenceful filing capacity now in this quarter when we achieved our first four-five, whereas as we had a very bleak H1 in terms of filings, because our R&D center was not ready consequent to the sale of Agila to Mylan. I am personally very happy with the way the business is tracking and the progress we are making in various markets; US is an important market, but it is not the only market that we focus as a company.

Anil Shah: You have talked about a run rate of Rs.350 crores to Rs.400 crores in due course of time as we move along. Any timeframe that you would like to share with us?

Arun Kumar: I am saying that we have already moved from Rs.50 crores to Rs.75 crores adjusted in less than three quarters. So it is a good momentum. We believe we will be able to keep that sequential momentum going in the company, and if you add the math in about three to four quarters, we can get there.

Hitesh Mahida: [Antique Stock Broking] Just wanted to know when do you expect this Shasun integration? Last time we had commented that we expect it to be over by first quarter of FY16. So are we still maintaining that or it will get delayed or it could be sooner?

Arun Kumar: I think that is our internal target even now, there are no changes, the fact that the Madras High Court has already commenced the shareholder meeting, conveying the first shareholding meeting is a good sign, we expect the Bombay High Court also to start moving in that direction. So, for now we are not changing any of the dates.

Hitesh Mahida: We have launched only two products — Buspirone and Tacrolimus during the quarter. So we still have not launched Calcitriol?

Arun Kumar: It has been launched this quarter.

Hitesh Mahida: Are we giving now any guidance for FY15 last…?

Arun Kumar: No, we are not.

Vrijesh Kasera: [Edelweiss] Which is the business that is contributing the most to our EBITDA rise, because last year we were tracking around 11% to 12%, now we are doing a run rate of around 22% odd and how we have been to achieve this improvement in our margins?

Arun Kumar: Yes, obviously, the regulated market is the highest in terms of EBITDA, but our R&D spend is almost entirely there, institutional business is smaller. So in terms of margins, percentage it will be regulated markets, emerging markets and Institutional business are very close to the company average, there is no big difference between these businesses.

Vrijesh Kasera: So even the Institutional business would be tracking the same company level margins?

Arun Kumar: Slightly lesser, but it is very close to the company.

Vrijesh Kasera: If you could answer, how we have been able to do it, so one part is the regulated market moving from the partnership model to our own front end…?

Arun Kumar: So that is actually temporarily counter-productive, because of costs of marketing have gone up as a consequence, because we still do not have the critical size that is required to be in that business, so we will get there soon.

Vrijesh Kasera: And in the emerging markets because Africa we were earlier racking a lower single digit or a lower double digit ….

Arun Kumar: Never a single-digit, it was four years ago when we had a single-digit EBITDA. In Africa for the last three years, the business has been at the company average.

Vrijesh Kasera: Any impact on the Nigerian currency on our numbers, the depreciation that we had?

Arun Kumar: We do have a small impact, but we also have hedges, and that is why we do not have FOREX loss this quarter.

Moderator: There is a follow on question from the line of Hitesh Mahida. Please go ahead.

Hitesh Mahida: [Antique Stock Broking] Our R&D spend doubled quarter-on-quarter. Just wanted to know should we take this run rate going ahead, or this is a slight aberration?

Arun Kumar: This is the minimum run rate going forward.

Hitesh Mahida: The four ANDA which you have filed, are in which segments, which area if you can throw some light?

Arun Kumar: Just these are standard, niche, difficult to make product range, or we also have some Creams and Ointments this quarter.

Hitesh Mahida: When do you expect the Malaysia facility to come onstream?

Arun Kumar: We broke ground during the last quarter. So by December of 2016 we should be ready to take validation lots.

Pulkit Agarwal: [Karma Capital] Could you just throw some light on the competitive intensity in the Soft Gel Capsules phase and are you seeing any additional competition there and how large of an opportunity do you see in that space?

Arun Kumar: First of all there are three parts to this Soft Gelatin business — one is Nutrition, second is the OTC, and the third is the Prescription. So, we are only in the OTC and Prescription; OTC is very small for us, Prescription is our larger business; the OTC and prescription is approximately $4 billion to $4.5 billion. We do not believe that there are more than five or six FDA approved players in this space, not many players because some of the molecules are very small, some of the molecules are large, it ranges from products which are small as $10 million to as high as a billion dollar. So, we do not see too much competition in this space, simply because I think the market opportunities are not so big for people to get excited about it, but we are in the niche, and it has done us good, so we hope to play an important role in that space.

Pulkit Agarwal: Sir any idea on how much of an opportunity is there in terms of patent expiries over the next two to three years in this niche of the market?

Arun Kumar: There are about close to about a billion dollar of products going off-patent in the next two to three years, Strides has already filed for those products, and we expect to be amongst the first movers in the first wave of product launches for those products.

Pulkit Agarwal: This is one billion of products combined, not per year?

Arun Kumar: That is right.

Sumit Singhania: How much the Antimalarial suppliers would have contributed in this quarter to be what

[Nirmal Bang] percentage, roughly?

Arun Kumar: Basically we do not give a split up of the HIV and the Antimalarials, but it is about 35% of the total revenues is Malarial.

Bhagwan Chaudhari: I have two questions: one is, can you please elaborate this Vancomycin case in detail, I could [Sunidhi Securities] not get it properly?

Arun Kumar: Vancomycin, we have a partner, and in the last eight quarters, we had an average profit share of around Rs.9 crores every quarter, this quarter we have not booked that Rs.9 crores, because we are currently reconciling chargebacks and the returns data, and pending that we have not booked those numbers, we expect the profits to be in that range, but at the time of reporting and audit completion, the work was not completed, it is still not, and therefore, we did not book those numbers this quarter. We expect to have better clarity during the course of this quarter, but we think it is only a one-quarter impact, even if it does not work in our favor.

Bhagwan Chaudhari: If it works in your favor, then this Rs.9 crores may come into the next quarter?

Arun Kumar: That is right.

Bhagwan Chaudhari: And secondly, earlier you were having plans to get into the Russian market. Now looking to the current conditions there, the depreciation of the currency, etc., are those plans in place, or we are waiting?

Arun Kumar: Every market takes four to five years to establish mainly from a regulatory standpoint, product registration. So all of that is continuum in Strides. It is the market we have identified, where we will be in the next three to four years, we are continuously investing money around registrations, product developments specifically for that market, and we will continue to stay invested. So we believe that these currency fluctuations in emerging markets is something that you have to live with, but that does not mean that these markets are not important markets to be operating in.

Naresh Suthar: [SBI Life] In the base quarter, you said that there is some adjustment, adjusting for that, the growth was 19% in the revenue line. So what was the adjustment, sir?

Arun Kumar: During that quarter we had taken over on a trial basis an API business to run for 90 days with an option for us to continue running that facility if we liked the business, so we decided against it after running that facility for 90 days.

Naresh Suthar: Secondly, sir, in the opening remarks, you said that you will be receiving some key approvals in the next couple of months. So can we expect Lovaza out of that, or it is still some time away?

Arun Kumar: I think we are a few more quarters away.

Naresh Suthar: These key approvals would be in similar lines, like $50 million to 60 million kind of thing, or?

Arun Kumar: Correct.

Moderator: Ladies and Gentlemen, as there are no further questions, I would like to hand the conference over to Mr. Kumar Saurabh for closing comments.

Kumar Saurabh: I will thank the Strides management to give the time for this call. Thank you all the participants for joining us.