



Earnings Call
Q2 FY 2014-15

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CAPITAL SECURITIES

Moderator Ladies and Gentlemen, Good Day and Welcome to the Strides Arcolab Q2 FY'15 Earning Conference Call hosted by Macquarie Capital Securities Private Limited. As a reminder, all participants' 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. I would now like to hand the conference over to Mr. Abhishek Singhal from Macquarie Capital Securities. Thank you. Over to you, sir.

Abhishek Singhal Good Evening, all. Thanks for joining in for Strides Q2 and Half Yearly Conference Call. We have with us senior management of Strides. I will first hand over the call to Mr. Arun Kumar for some opening comments and post that we can take in questions. Sir, over to you.

Arun Kumar Thank you, Abhishek, thank you hosting us and thank you for those who are joining us, we do understand there are significant other earnings calls going on at the same time, so, we appreciate your time today. I am actually very-very happy to report a very robust quarter for the company. We seem to be doing very well with all our segments and that is the result that we are hoping to have this quarter. More importantly, our Institutional business still not have had any positive impact on the Anti-Malarial business, which we now have secured significant orders to be comfortable in terms of what we guided in terms of number of doses that we may be able to supply. So, going forward from this base line, we think we should be in a good position to ramp up both our top lines and improve our profitability, which has already seen some significant improvements in the last quarters.

It has been a very busy quarter for Strides. There have been significant corporate actions, obviously, the large one being the announcement of the Shasun merger subject to various approvals. We are also pleased to announce the successful closure of the Bafna domestic business including Raricap and that takes us to an all-India player for our domestic business which is extremely important given that we have been a very regional player. During the quarter, we have acquired a very small CIS focus company, which predominantly had significant registration opportunities, but was not trading. So, we hope that Fagris will give us kind of a quick start or an early entry into the CIS markets as that becomes our next focus after Africa. We also announced the strategic investment by GMS Holdings and with a \$40 million investment by Strides that we would have fully funded our Biotech business. That obviously gives the Biotech business cash and focus to achieve its near-term goals. We finally settled with Mylan on the holdbacks and we have had multiple discussions around this and we are happy to have received \$150 million on the holdbacks and distributed Rs.105 to the shareholders.

The global Pharmaceutical business had a very significant improvement in EBITDA; EBITDA grew by over 66% over the corresponding quarter and EBITDA percentage grew over by 600 basis points, and this is predominantly based on our calibrated approach on product selection, profit maximization that we have been focusing on ever since we sold Agila, as we are building the business both for scale and scope. We continue to focus on designing and developing products which are scarce, small molecules with a niche, a very successful launch with Methoxsalen where we have taken a significant market share although the unit numbers and dollar value on the product is small. It is important for us

to keep building a portfolio of niche products. Vancomycin in the US continues to maintain leadership position with our partner Alvogen and we are seeing a lot more consolidation in that market share. So, that is a very interesting growth that we are seeing even after 8 or 9 quarters of launch.

Significant investments in infrastructure have been made. This quarter we have had 5 major manufacturing or R&D centers going on stream, so a new R&D center in Bengaluru for Pharmaceuticals, a new R&D center dedicated for Biotech and the 2 packaging units in Namibia and Botswana for our emerging markets business with focus in Africa and a dedicated manufacturing facility for the African markets and the emerging markets also went commercial this quarter.

As everybody knows our focus had been on creating a bunch of capabilities around our Injectable portfolio which post the Agila sale created a lull in our filing momentum and I am now pleased to report that Strides has managed to get back to its stated filing momentum of products or our established momentum I must say, and we are very comfortable to get to a very important number of filings starting from H2. We had a fairly small amount of number of filings in the last couple of quarters, because we were ramping up our R&D around that.

Finally, on the Biotech, we will also announce the construction commencement at Malaysia, long delayed I must say, but we announce for all the challenges that we faced and it is also important to note that 2 of our key products have reached animal toxic study stage this quarter. So, there is progress both on the manufacturing, R&D, and on the development phase of our Biotech business.

In terms of the business split, there is hardly any change in our composition. Margins have improved significantly and we believe the recently signed a partnership of Institutional Business with Gilead for the Hepatitis-C products for 91 countries would be an important step up to our Institutional business. Obviously, we are very excited about the opportunities of being fully integrated, post the Shasun merger on our API for our Anti-Retrovirals business and we would see momentum around this business. But, pleasing of course has been the emerging markets performance very significant both in terms of profits and in terms of top line and we believe that momentum will continue and the emerging markets will continue to get traction Q-o-Q and we will have to probably face a few more quarters of a little peaks and valleys, before it stabilizes to a very important business as we are growing this business very aggressively. So, we obviously continue to generate important significant cash; our EBITDA-to-cash conversion ratios have improved, our working capitals have reduced, we continue to be a debt-free company even post maximizing a dividend payout. And both products Methoxsalen and Imiquimod are doing to satisfaction. As the quarters move, we expect one or two more key launches of products that have been approved and that should improve traction in our regulated business too. Interestingly, we are getting some very nice niche products in Europe. I am also pleased to announce that Vancomycin has now been approved through a DCP process in Europe and we should have commercial supply in Europe starting from Q1 of next year when we have national filings in each of these countries. That would probably give us leadership not only in the US market but also in the important region of Europe where Vancomycin is widely used. We believe that

we again would be the first generic in most markets and that could be another nice niche that one can see.

So, apart from continuing focus on the US, we are building portfolio globally in other reg markets and we are seeing the traction all around and that is primarily the reason why we have seen an improvement in profits and in our cash flows.

So, thanks for listening and me and my colleagues are here to assist in addressing in some of your questions if there are any and I will be more than happy to answer. Just one clarification on the EPS is that although our reported EPS is 8.51 adjusted for the Biotech expenses and the merger expenses that we have written off, the adjusted EPS is 9.63 which is a very important step up on our EPS growth compared to past quarters on our retained business. Thank you.

Hitesh Mahida

[Antique Stock Broking]

Sir, first thing, emerging markets business has seen a significant growth. So, has there been integration? It was really integrated during the quarter. If not, then what is driving this growth?

Arun Kumar

All the emerging markets growth has come from Africa and that is primarily because of our increased focus on medical reps and productivity there and also some of our newly setup facilities in Namibia and Botswana are already tracking business.

Hitesh Mahida

What would be your MR strength in Africa then?

Arun Kumar

We currently have 200 medical reps and we are in the process of adding another 100 in the next 6 months.

Hitesh Mahida

When can we expect this Artemether Lumefantrine supplies to commence?

Arun Kumar

From Q3.

Hitesh Mahida

Sir, you said that we are expecting commencement of supplies for overall Vancomycin in Q1 FY'16. So, just wanted to know what would be the size of this product in Europe?

Arun Kumar

It is still a hospital product, in the sense, that it is used for hospitals infected diseases. So, the IMS gives you very different kind of opportunities in terms of market size. But, in our estimate, the market is approximately half the US market, which means it should be about \$100 million in all the European countries.

Hitesh Mahida

Sir, can we expect this Raricap being integrated from Q3?

Arun Kumar

Raricap has been integrated as of 4th or 5th of October. So, you will see the impact of Raricap in this quarter.

Hitesh Mahida

Sir, wanted an update, have you launched Tacrolimus in US?

- Arun Kumar** Will be launched this quarter.
- Hitesh Mahida** And Buspirone also?
- Arun Kumar** That is right.
- Hitesh Mahida** Sir, Fagris Medica we had acquired for the Russian market. So, just can you throw some light, what is the current sales?
- Arun Kumar** Fagris has got very-very suboptimal sales, but it does have registrations which is the reason why we acquired that company.
- Hitesh Mahida** How much we have paid for this acquisition?
- Arun Kumar** It is like I said, we have paid for the registration, it was sub-\$200,000, it is not a major transaction but it was important from a strategic perspective.
- Hitesh Mahida** Sir, Shasun Pharma had posted EBITDA of around 6.4% during this quarter. So, just wanted your view as to where do you expect this EBITDA margins to go once say maybe 2 or 3 years down the line once it gets integrated with...?
- Arun Kumar** That is post the approval of the merger.
- Karthik**
[ICICI Securities] This is Karthik here. I just wanted to understand that our EBITDA margins improved substantially now. What would be the outlook and would you want to give a broader range for the next 2-years assuming our sales mix from both the regulated and similarly regulated market would actually remain the same?
- Arun Kumar** To answer your question differently, we are unable at this time to give guidance especially because we have announced a significant corporate action concerning Shasun. There is a lot of work that can be done now, that is allowed to be done now, and there is a lot of work to be done later, and we are in the process of doing all of that, before we can guidance on what we think the EBITDA we will get. We have some idea, but obviously, it is too early to bring into the attention of the public domain. At this stage, all I can tell you is that the retained businesses of Strides has reached a certain EBITDA range where a lot of work has happened in the last 2 years from single digit EBITDA margin it has gone to a healthy 23% on the base business. We believe that we should be able to be in this 20 - 25% range for the next few quarters and that is our current focus while we work on all the benefits of synergies and integration with Shasun in the near term.
- Karthik** If I have to ask a question excluding Shasun, in terms of API synergies that you are able to get, so I would just want a direction from you if you have to exclude Shasun, do you believe EBITDA margins of the Retained business of Strides can be near 25% about 2 years down the line?

- Arun Kumar** That is what I am trying to tell you, our goal is to get to 25%, we have gone from 11% to 23%, so, we are not very far from that goal and I think we can achieve that in the very near term.
- S. Viswanathan**
[Unify Capital] I like to know the addressable market size of the two products that we have launched in the US this quarter – Methoxsalen Softgel Capsules and Imiquimod Cream?
- Arun Kumar** The Methoxsalen market is very small, it is about \$14 million, but there are no generics, we are the first generic. And Imiquimod, it used to be a lot more than that, but currently there are about 5 or 6 players and it is about \$200 million in terms of market opportunity.
- S. Viswanathan** Second question is, could you quantify the anti-malarial order that you have got?
- Arun Kumar** We have already given a guidance that we should be approximately in 15% to 20% of the market opportunity. The market opportunity is about 250 to 300 million doses. So, that is on an annualized basis. We think we should get there soon, we are very confident that we should be in that range.
- Kumar Saurabh**
[Macquarie] I have this question regarding Bafna acquisition. What kind of synergy benefits we can expect from this acquisition? I believe you mentioned that during current quarter's number, we do not have any sales from Bafna acquisition. Am I right?
- Arun Kumar** You are right. One is Bafna gives us a pan India range, outside of where we still are not present in Rajasthan and Punjab. Before this we were a pure play south Indian Pharmaceutical company. That obviously has changed. Second, Raricap, it is a Bafna product, who was originally Johnson & Johnson product, and it a very-very popular drug in the Gynec markets. So, this kind of gives us the pull in key metros where we want to be present and we believe that the Strides portfolio will write the tailwinds of Raricap, as Raricap is very-very popular drug amongst the gynec fraternity, and will also allow us to get into a new domain outside of diabetes where we are currently focused. So, yes, it gives us a pan India range, it gives us scale. So, always see even with Bafna we would be a sub optimal Indian branded company, but this is a 4 to 5-year game for us before we get to size and we will look at further acquisitions that are accretive like Bafna, and those assets are not easy to find and not cheap to buy. So, we will be very focused on how we allocate capital around this business. But we think that the Bafna acquisition will give us significant scale in the near term, and obviously, the marketing and distribution is managed by Strides, the Bafna medical reps have been integrated in to the Strides team and they are cross selling each other's products. So, obviously we get synergies of cross selling too.
- Karthik**
[ICICI Securities] I just wanted to ask you what is the tax rate that we should assume now that our Institutional and other market business are earning higher profits – will we be above MAT? Second is in terms of expansion, what is the CAPEX that we should assume for FY' 15 and FY' 16, this is both ex of Shasun?
- Arun Kumar** One of the other things that probably I missed out in my opening statements is that we now have a global international headquarters status in Singapore effective from June. So, we already have some benefits of tax as Singapore becomes a global headquarters for logistics, storage, and supplies. This

will improve our tax rate to be between 14% and 16% for the remaining part of the year, if not slightly better. And your other question was CAPEX. We do not have anymore CAPEX because we have already commissioned our R&D centers, both in Biotech and in Pharma and we completed our major expansion, we currently have a very small expansion that is going on to include Liquids and Creams from our Indian facility which will get over before the end of the year, which is already factored, which was communicated earlier as Rs.40 crores for the whole year. So, with that there would be no more CAPEX.

- Karthik** Can you share the geographical breakup for the first half of this year?
- Arun Kumar** Our North American business is about 10% in H1, we call all other regulated markets outside of North America which is 30%. Our Institutional businesses does not have a geographical split, so that is about 29% and Emerging markets which is Africa, India, and parts of CIS is 32%.
- Karthik** This is for the H1 number, right?
- Arun Kumar** Yes H1.
- Karthik** Would Emerging Market and Institutional, they would both have some sales in the Africa region, am I right?
- Arun Kumar** Institutional business, we do not classify it in to any regional markets because they are donor-funded, so, technically the funds come from US. So, you have to assume that Institutional business goes all around the world with predominant focus in Africa but we do not add that into our geographical spread.
- Karthik** How much would Africa be out of Emerging Markets roughly? We do not want the exact percentage because that would help.
- Arun Kumar** 70% would be Africa.
- Bhagwan Chaudhary** [Sunidhi Securities] First of all, we acquired some 90% stake in Fagris Medica India. So, can you please comment on that – what kind of business that is and what is the quantum and size we have acquired?
- Arun Kumar** As I was explaining earlier that Fagris is predominantly a company which has got multiple registrations in the CIS region, it was a dormant company for various reasons and we have revived the business already and we have already started commencing shipments based on the registrations that was acquired, it was predominantly acquired for registrations and not for topline. At acquisition, it did not have any topline, but we think we will be able to ramp up sales as we are improving positioning and sales and marketing efforts are on the product registrations and sales have already commenced as we speak.
- Bhagwan Chaudhary** Secondly, on Emerging Markets, what were the sales growth on Y-o-Y basis?

- Arun Kumar** Because we had Agila also part of our Y-o-Y, we have not done that split because we need another quarter before we can, we can only give that Y-o-Y from next year, but just to give you an idea, the business is growing at around 60% over last year.
- Bhagwan Chaudhary** Just want to understand this was some seasonality effect on Q-o-Q basis or it was underlying growth?
- Arun Kumar** It is underlying.
- Dheeresh Pathak**
[Goldman Sachs] Sir, you said that 300 doses and you will have 20% market. One dose is how many dollars?
- Arun Kumar** It is 300 million doses, the average price of dose ranges between 80 cents and 95 cents. So the market opportunity is between \$240 to \$275 million in our estimates.
- Dheeresh Pathak** For FY'15, as a year, we will do 20% of that or this could be...?
- Arun Kumar** No, we would not be able to do that. The business has commenced, we have seen visibility of that on an annualized basis.
- Dheeresh Pathak** But the tender would have been for two years, right? If half of that we get in this year, then FY'16 would have like 1.5 years of, I am just trying to understand which...?
- Arun Kumar** It can spill over because the supplies have started only from October, it can be from October-to-October, need not be ...
- Dheeresh Pathak** If the supplies of AL were not in this quarter, then Rs.81 crores, what is that then?
- Arun Kumar** That is our current business of Antiretrovirals.
- Dheeresh Pathak** Can you just talk about this Sovaldi opportunity? Does it stop you from challenging patent of Sovaldi in regulated markets?
- Arun Kumar** Why should we challenge when we have a voluntary license from Gilead. So Gilead has given us a voluntary license to manufacture the finished product, they gave us technical access to the dossiers and we are allowed to sell in 91 countries where hepatitis-C incidents is in excess of 100 million patients. The current treatment dose which Gilead sells is around \$84,000, treatment dose for 3.5 weeks in the regulated markets. Gilead expects access to these 91 countries. We have got freedom to price, but we believe prices will be in the \$1,000 to \$2,000 range depending upon the country and the number of patients one caters to and what patient support that you offer. From that opportunity perspective, it is very large. So if you do \$1,000 pricing and you do 100,000 patients and it is \$100 million business, but how quickly one can get there and how rapidly one can take leadership positions in these markets where there is high incidence of hepatitis-C is a matter of fact. Strides is little ahead of the curve. We have already started work with the Government of India to get fast track

registrations. We have already started developing the product. So it is an interesting business opportunity but it is little early to tell you where this business can get us. So I am not guiding anything on this as yet.

Dheeresh Pathak So they will do this so that you do not challenge their patent for the US regulated markets where they make \$84,000?

Arun Kumar You cannot challenge something, this product got approved six months ago and even if you want to challenge it there is no point challenging anything now which you can sell 20 years from now. So really does not make any sense. And we partner with Gilead with a lot of other products and we believe that this partnership is extremely strategic and prestigious for Strides and we are really not interested to compete with Gilead, we are looking at collaborating with Gilead and trying to create access and affordability and try and find market opportunity which is otherwise not available to many companies.

Dheeresh Pathak Can you give how many ANDAs now are pending approval?

Arun Kumar We have 12 ANDAs pending approval, we had a flurry of approvals recently.

Dheeresh Pathak How many are you filing, like the filing run rate is 10 ANDAs per year or so?

Arun Kumar We have got now a momentum of around 20 filings per year. So the first year is going to be a little slack because like I explained in my opening commentary we just got the new R&D centre up and running. So we have little infrastructure challenges while we are migrating from Agila to our own facility. So we are now good for probably 8 to 9 filings this year and then get to that 20 to 24 filings per year from next financial year.

Hitesh Mahida: Just wanted an update on this USD100 million remediation money kept in escrow account. So last call [Antique Stock Broking] we had mentioned that we can expect around \$40 odd million over the next 6 to 9 months. So sir, any update on this?

Arun Kumar No change in updates.

Hitesh Mahida We had filed for two Derma products from our Italian facility. So any guidance as to how many more we plan to file for this particular segment from the facility?

Arun Kumar First, we only have one product filed and approved from Italy and this year we will have another two or three filings from Italy. I do not know where you got this data from.

Abhishek Singhal Thanks, Arun for taking this call. Thank you very much participation in Strides call.

Arun Kumar Thank you, all, thank you very much.