



“Strides Pharma Science Limited
Q2 FY24 Earnings Conference Call”

October 30, 2023

MANAGEMENT:

1. MR. ARUN KUMAR

– FOUNDER, EXECUTIVE CHAIRPERSON &
MANAGING DIRECTOR

2. MR. BADREE KOMANDUR

– EXECUTIVE DIRECTOR - FINANCE & GROUP CFO

INVESTOR RELATIONS: MR. ABHISHEK SINGHAL

Moderator: Ladies and gentlemen, good day and welcome to the Strides Pharma Science Limited Q2 FY24 earnings conference call.

As a reminder, all participants' 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 this conference, please signal an operator by pressing "*" and then "0" on your touch-tone phone. Please note that this conference is being recorded.

I now hand the conference over to Abhishek. Over to you, sir.

Abhishek Singhal: A very good afternoon and thank you for joining us today for Strides' earnings call for the second quarter ended financial year 2024. Today we have with us Arun – Founder, Executive Chairperson, and Managing Director and Badree – Executive Director of Finance and Group 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 website. The transcript for this call will be available in a week's time 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 any further questions, please feel free to reach out to the Investor Relations team.

I now hand over the call to Arun to make his opening comments.

Arun Kumar: Good afternoon and good evening to everybody joining in. Really appreciate your time today. I know it's a busy earnings sequence. So, we appreciate your time today. We have reported a very strong quarter. It's our sixth consecutive quarter of absolute EBITDA growth and also an all-time high in terms of revenues. Just to avoid some confusion that could have occurred with our SEBI reporting, I would like to mention that the Rs. 269 million shown as the other income is an income earned on IPs which are in our normal course of business. And it is not a one-off income. As the company moves more and more to B2B, a part of its business model is to license products to partners and also would get upfront payments for licensing incomes but also for use of IP. I just wanted that to be clarified so that there is no confusion on the numbers. Having said that, it's a milestone in terms of revenues for the company to have crossed Rs. 1,000 crores. All businesses have done well. There has been no business that has underperformed. We provided unusually guidance as we were busy resetting the company since the last 6 odd quarters, and I am pleased to confirm that all our outlooks are on track to stay with revenue growth at 15% on continuing business. This has already been 16%. Historically H2 was significantly stronger half of the year, and we are therefore confident of even beat the revenue growth. The exit run rate of the company in this quarter on constant currency is approximately \$500 million of run rate and I think that's a decent base for those of you who follow us and write about us to consider as a more reset pace after course correction. We are also pleased to guide our EBITDA now to the

higher end of the range. This is based on our strong order book in H2. Several product approvals that we received recently including a critical product as well as generic Vascepa which would be launched in this quarter, thereby giving us confidence that we will be closer to the higher end of the range.

We are also pleased to see a significant improvement in our net debt to EBITDA ratios. We started the year in FY22 with the reset close to 8x. We ended FY23 at 5.3x. H1, this has now improved to about 3.3x. And with the continuing free cash generation, we are very confident of meeting our net debt to EBITDA target of under 3 in FY24 as we had committed. Our network optimization program has been completed. As many of you know and as we had guided earlier, we mothballed our Singapore unit since the last 2 years considering that we have now had a manufacturing facility in New York. Singapore, therefore, became unviable for us to operate because it was mainly meant for the VA business and the government procurement programs which qualifies produced in Singapore. Considering moving all our critical products to the Chestnut Ridge facility in the US, this facility had become redundant. So, this was sold although we incurred a one-time loss. This improves our EBITDA and EPS flow-through by almost about Rs. 60 crores a year considering that a significant part of the depreciation line item included lease rents which was part of our Singapore asset that we acquired. This will improve both EBITDA and below EBITDA line items. All of these proceeds will be used to reduce debt further with our net debt reduction of Rs. 62 crores. This is in spite of the fact that we continue to invest for our CAPEX for our ongoing CAPEX needs in India but also in the US, but also the fact that we grew the business by 16%, our focus on free cash generation, reduction in our cash-to-cash cycle times which has been reduced by 30 working days approximately from FY22 to now to just under 125-126 days. And we will further work through those days as our business quality improves.

The business moving more and more to B2B will mean that our licensing incomes will continue to grow. So also there will be a reduction in our cash-to-cash cycles resulting in further improvements in our debt book. Specifically, if I take regions, the US, we guided in the last call of revenue guidance of \$240 million to \$250 million considering H2 is a significant part of our US business with our cold & flu and acute therapies. And with some important product approvals like the ones I mentioned in my opening statement, we are now very confident of achieving the higher end of our guidance of \$250 million. With the completion and closure of the warning letters issued to Pondicherry which was closed last quarter, we are now expecting new product approvals, and a continuing work on getting products that we acquired through the end of portfolio, that continues to be brought to India to be more competitive, and to have more robust manufacturing processes around them. Approvals around them also continue to grow.

The stellar performance from our other regulated markets was mainly driven by a continued growth of business in Australia, the Nordic regions, and a significant uptick in our business in continental Europe, consequent to a complete shift to B2B in these markets. We continue to add new partners. We continue to get several products approved, several products filed, and we

believe our front-end operations in the UK and the Nordics added by our strong partnership model in the rest of Europe will help us drive this momentum; and our strategy obviously is to have the other regulated market mirroring the US market so that we de-risk the higher dependency on the US business.

We feeded the growth markets, as we call them. As you will see that the growth markets have started to show results. We are continuing to develop these products with these markets with increased focus on new geographies and new portfolios. We believe in the next 2 to 3 years, the growth market and the access market will become as important as a market as the rest of the world via the regulated markets.

Overall, it has been a pleasing result for the quarter. A lot of the work that we had invested in the last 8 odd quarters is now playing through. We are very pleased with our operating leverage, free cash generation, gross margin improvement which at close to 60% is almost industry high considering that we do not have a domestic business.

And again, the one-offs in Strides with all the work that we are done with network optimization is complete. A loss picked up from our JV as we guided in Stelis from our associate company, Stelis from H2 will be very negligible. The business in H2 will be EBITDA positive. We continue to add significant new contracts in our CDMO business in OneSource and we expect to close to Syngene transaction as guided in this quarter. Consequently, our targeted debt reduction of about 700 crores between the two companies will fall in place but will also release a significant amount of corporate guarantees of Strides. So, in all, we are very close to achieving everything that we committed to would be our focus and I think we got the company back to a stage of continued growth. You would see significant upsides in terms of new product launches. We have some several nice products coming our way in the next couple of quarters, and we will keep you posted as soon as we get those approvals and give you continued information on market share.

We continue to see important price stabilization for our portfolio. There are cases where we have price pressures on 1 or 2 products. We apply a very disciplined approach to product market share and that's not on price leadership, but because of our large portfolio of products, we can afford the luxury of letting go of the pipeline of products that don't meet our margin criteria. Having said that, we have enough ammunition with products approved or under process of site changes from Chestnut Ridge to India for us to be more competitive.

Overall, a good result and we will continue to grow from here. Our focus obviously now is the conversion from EBITDA to free cash and to ensure that the PAT percentages increase, considering the one-offs are all sorted or solved for.

That's the general overview of the quarter. We are excited about the prospects for the second half, and we continue to be very excited about OneSource that we announced recently. And we

believe that there will be significant value accretion for all our stakeholders in the coming days. Thank you for your patience, and both Badree and I are very happy to take any questions that you may all have.

Moderator: We will now begin the question & answer session. Ladies and gentlemen, we will wait for a moment while the question queue assembles.

The first question is from the line of Rohit Mundra, an investor. Please go ahead.

Rohit Mundra: My first question is on US business. We have sustainably achieved 60 million quarterly run rates now for our US business and I think we are very much on track for our FY24 guidance. What will drive the next level of growth and how should we look at this base of 240 million growth over the next couple of years?

Arun Kumar: We have mentioned that to maintain the kind of margins that we are focused on in the US market, we would speak out closer to \$400 odd million. That's our first milestone. We have all the products approved to get there. We believe that this can happen in the next 2 odd years, as we slowly build up this business with the kind of margin profile that we are currently operating at.

Rohit Mundra: And secondly, could you provide your view around the current competitive scenario in the US market and something around the price erosion that we have faced during the quarter?

Arun Kumar: I think that there is generally a more disciplined approach in terms of pricing both with the buying universe and the selling universe. That doesn't mean that there aren't one-off irrational pricing that we see. So, it's a lot better than what it used to be, but it's not vanished from the marketplace. Although the product shortages are increasing, rational pricing still continues. Considering that we have a very niche portfolio with over 30 products of ours in 1 or 2 in terms of market share for many years, we have been able to maintain these market shares. I am not saying that we are not immune to price pressures, but it is relatively small for our type of business.

Moderator: The next question is from the line of Aman Vij from Astute Investment Management. Please go ahead.

Aman Vij: My first set of questions is on our GLP-1 portfolio. Sir, in the last call, you mentioned that we had made some solid investments in devices and are a leading drug device player globally. I would like you to elaborate more on this part. Are we saying that we have started manufacturing these self-injection drug delivery systems also, which is required for GLP-1?

Arun Kumar: The GLP-1 is part of Stelis which is an associate company of Strides. We currently have about 15 customers and we partner with several companies worldwide and we have filed all the weight loss and diabetic drugs which are in drug device formats and a lot of other programs too. So, to

answer your question, we are in a very strong position. But the patterns for this start going off partially in FY25 and the main patterns get off only in 2030. So, commercial supplies will not start quickly. But having said that, we do get a lot of R&D income and we do hold a very large order book for our contract manufacturing opportunities led by GLP in OneSource which in a company that we just announced is a carve-out in the last quarter.

Aman Vij: The clarification was left on the comment of leading drug device manufacturer globally. You are saying we have started manufacturing the devices – the drug delivery system self injections – in the subsidiary, OneSource?

Arun Kumar: Yes, what I am saying is that we have already started manufacturing products for several customers who have made their filings with the regulators, and once their products get approved and when the pattern regime opens up, we would start commercial production. At this time, their development and filing batches that we have done for companies.

Aman Vij: And you mentioned there are like 14-15 customers. And in the last call, I think it was also mentioned that they have given some kind of rough visibility of around \$300 million number in the next 2-3 years. So, according to your estimate, these 14-15 customers will have what kind of market share combined? Can we as CDMO partner for them, can this be like 10-20-30% market share opportunity for us?

Arun Kumar: We can't predict market share on behalf of our customers. A model of the CDMO is to do services, and if a customer wants capacities, either they reserve those capacities on a takeaway basis or a contract. And based on certain sensitivities that we do on these forecasts, we believe that our peak revenues will get to about \$300 odd million in the GLP programs, but that is dependent on our partners getting approvals but also when we can actually start selling given the pattern regime in various countries. So, I can't give you more specifics beyond that.

Aman Vij: And you said initial sales will happen some part in FY25. My understanding is I think this is you are mentioning for liraglutide. So, liraglutide sales FY25 and FY26, can it be like \$50 million kind of sales, or it will also take time to come in?

Arun Kumar: Sales will commence, but I'm not willing to put a dollar number.

Aman Vij: Just one final clarification on this part. We used to have a tie-up with international player Owen Mumford for the drug delivery devices. Given now we have it in our own subsidiary, that tie-up is no more valid, or we will do both the things? We will have tie-up with the international platform companies as well as we will do....?

Arun Kumar: Owen Mumford is not a platform company; it's a device manufacturer. We have several device manufacturer partnerships. They make the device, and we make the drug device, so we put the drug in the device.

Moderator: We have the next question from the line of Shantanu Maheshwari, an investor. Please go ahead.

Shantanu Maheshwari: My question is regarding the other regulated markets' performance which has been quite strong. And we had mentioned in our other regulated markets slides in the investor presentation that we have a strong funnel for the European B2B partnerships under the SynergICE to drive growth. Can you please put a little bit of light on this?

Arun Kumar: SynergICE is the name of our B2B platform. It's a platform that sells capabilities for both OneSource and for Strides under one platform so that we offer multiple services to a customer, and SynergICE is only a logo of the B2B arm of Strides. And we partner with major companies in Europe and out-license our products and that is how we get licensing income, profit shares, and all of that. And SynergICE is the logo that we use for the customers to differentiate our B2B business from our B2C business.

Moderator: We have the next question from the line of Nitin Agarwal from DAM Capital. Please go ahead.

Nitin Agarwal: Arun, alluding back to your remark, just to reconfirm that you said the US business sales for us can be \$400 million in the next couple of years?

Arun Kumar: I am saying that if we want to do a calibrated disciplined approach for the US business, in spite of us having so much of approved pipeline, we will believe that \$400 million is the right size for us to keep the margin profile that we currently achieve in the US, and also to have a backup when we are challenged on certain products.

Nitin Agarwal: But by when do you see getting to the \$400 million marker, sir?

Arun Kumar: I would assume not later than 2 financial years from now.

Nitin Agarwal: Secondly, in terms of your mentioning about some meaningful launches being there in the second half of the year, is there a number which you have in mind and these launches are what we are talking about meaning launches are more than \$20 million products?

Arun Kumar: Yes, Nitin, we have moved up the ante in terms of our average product range being \$4 million to \$5 million to now products delivering more than \$10 million to \$12 million. You will appreciate that Icosapent should be about \$20 million product by default of the size of the market opportunity. And there are certain other products that will come our way very soon. So, yes, we should have 3-4 products which are \$20 million and above by the end of the year, I mean exit run rates.

Nitin Agarwal: Is it fair to assume that bulk of the revenue realization from this product should be visible next year depending on what time of the year in the second half it will hit the market?

Arun Kumar: Yes.

Nitin Agarwal: Secondly, on the operating leverage which is inherent in the business, with the scale up that we are talking about in the business, again, is it fair to assume that we have been really consistent with our overheads position now over the last 2-3 quarters? Does this \$200 million sort of annualized run rate for overheads sustain? And then whatever incremental gross profits you make sort of flows to the EBITDA and PAT?

Arun Kumar: Yes, you are right. We don't believe our OPEX levels are going to increase greater than \$200 million for several years. And that is because of our very keen focus on costs and also a lot of things that we do in terms of optimization, OPEX leverage, and OEE improvements in our plants. Having said that, the only variable would be the freight and associated warehousing costs for increased revenues, but for that, the flow-through from gross margin to EBITDA could be strong. And we believe that will be the singular pointer towards improved EBITDA margins.

Nitin Agarwal: And if I just take that forward, what does it really imply for your EBITDA targets for this business, the ex of the gelatin business that you will dispose of rather divesting to OneSource? If you look at Strides as a business, over the next 2-3 years, where can net debt to EBITDA levels be for this business?

Arun Kumar: You are talking about net debt to EBITDA levels?

Nitin Agarwal: Yes, net debt to EBITDA levels.

Arun Kumar: We firmly stand by our guidance that in spite of about 150 crores of EBITDA moving to OneSource, we will still achieve our current EBITDA. So, effectively, we are telling you that like to like, our EBITDA will be closer to 950 crores in the next year. So, in spite of 150 crores of that moving away, we would still achieve our current EBITDA and revenues. There will be no drop in revenues and EBITDA. And we believe that in the next 2 years, our debt to EBITDA therefore will be much below 2 given the strong performance that we are now achieving through our reset.

Nitin Agarwal: And the last one; when you look through again in the next 2-3 years, given the way you are thinking about the business, do you see opportunities or avenues for meaningful inorganic growth using the cash flow that will come through or how do you envisage the business growth over this period of time?

Arun Kumar: Not in the case of Strides. I think the cheaper assets are in markets that we probably don't want to expand beyond the size, which is mainly the US. All other markets are not necessarily cheap. We are breathing a lot easier now considering where we started the reset. And I think we need another 2-3 quarters of consolidation and reduction of debt which is what we are focusing on. The debt is not an overhang, it's working capital debt. And with \$35 million moving away to OneSource, it actually becomes even better for Strides to operate. But I think for the next 2 to 3 quarters, our focus would be to improve our C2C which like I said in my opening, started off as

150 odd days is now 127. Our target is to bring that down by another 15 days so that we don't have to worry about incremental working capital in spite of 15% to 16% top line growth. That's our focus. I think maybe you should ask this question to us after about 3 to 4 quarters.

Moderator: The next question is from the line of Sarvesh Gupta from Maximal Capital. Please go ahead.

Sarvesh Gupta: Just for clarification on that US business; currently, we are trending around 16% odd annual growth, and while you are saying that we can reach maybe \$400 million in a couple of years. That would mean around 30% CAGR. So, are we talking about doubling the growth in the US in the coming 2 financial years?

Arun Kumar: Basically what I said is that if you look at our exit run rate for us to be at 250, the exit run rate will be close to about \$270 million to \$280 million. So, if we do an absolute number of 240, the exit run rate is about 270 to 280. You calculate from there on. And it is not a 30% CAGR. Obviously, the US growth is going to be stronger because I was explaining to Nitin, most of our new products are in the \$15 million to \$20 million range compared to our historical \$5 million to \$7 million. That is the reason why we are reducing the time while the growth on the other markets will be slower but a lot steadier.

Sarvesh Gupta: Given the strong traction that we have now found in the other regulated markets, would you like to call out some sort of a guidance in terms of growth or where we want to be in a couple of years?

Arun Kumar: It's too early to call out for guidance, Sarvesh. Our idea is to grow the other regulated market as a mirrored market to the US. If our product design strategy plateaus at \$400 million in the US, we would like the other regulated market to mirror that size. So, it will take us a lot more than 2 years to get there considering that currently our exit run rate is likely to be about \$200 million, which is almost 50% growth in the last 2 years. So, we think that there's a lot of momentum coming there. And then as you can see, we are also building the growth markets. So, we have 3 layers. And we will probably plateau the growth for the US, not because the opportunity is not there, but because we may not want to grow that business beyond that because it may kind of impair the pristineness of our margin focus for that market. That's more it. The idea is to build other regulated markets to mirror the US market. But that's not going to happen in 2 years. It's going to take probably 4 or 4.5 years. But that's the idea; can we create 2 or 3 mirrored markets in terms of revenue and margin profile.

Sarvesh Gupta: And finally on the exceptional items. This facility that we have sold, it looks like we have only realized maybe 50% or lower of the book value of that asset. Any particular reason why we had to incur such sort of a sharp drawdown on the stated book value?

Arun Kumar: One is that obviously we had mothballed this facility now for a good 2 years ever since we bought Chestnut Ridge and post-COVID Singapore for generics just became very unviable. So,

we had a choice to continue to mothball or just move on because like I said our focus now is the EBITDA to cash credit to EPS conversion. And while we took a one-off hit, this delivers close to 70 crores of margin improvements from EBITDA to PAT and that made better sense to us and also from a ROCE standpoint. So, we have completed everything that we needed to do to build the company for the next 3 to 4 years. And we didn't want to have any overhang or any extraordinary exceptional coming forward in the Strides system which will not be there. I can confirm that. So, it's just to move on which didn't probably add to the strategy going forward.

Sarvesh Gupta: And this 15 crore one-off cost increase in the other OPEX, what was that, sir, in the personal cost?

Arun Kumar: We had a policy earlier where a lot of our colleagues in Strides were on variable pay. As part of our banding exercise and other programs that we did, we realized that only about 70 or 80 people make significant direct impact to the P&L and everybody else are subject matter experts or very important associates of the company. So, rather than making variable pay a function of uncertainty for employees, especially when we are coming back from a difficult chapter, we decided to cut off the variable pay for several of these employees but added it back to their CTCs. That is why we took a one-off. But we are now provisioning that on a quarterly basis. So, you will not see this regularly. And the new base of 185 crores is now a personal cost which will be more or less steady state going forward except for standard increases on an annual basis.

Moderator: The next question is from the line of Aman Vij from Astute Investment Management. Please go ahead.

Aman Vij: Sir, if you can talk about where do we see our CDMO business in the next 2 years?

Arun Kumar: The CDMO business, once OneSource is up and running, we had put up a detailed presentation. We said that the business will be about \$160 odd million at the launch year which is next year after the NCLT process is complete, and we expect the business to hit \$400 million in FY27.

Aman Vij: Sir, I was talking about one of the products which we had launched a few months back.

Arun Kumar: I guess, Aman, you can ask me this several times. I am obliged not to give you any of that information. We work with partners. We have committed to confidentiality. So, I can't give you the kind of granularity you are seeking in our CDMO business.

Aman Vij: No, my question is not on that side, sir. My question was on the other product basically which is Teriparatide. We had launched this product in the Europe market, and I believe a US opportunity is also coming in. Are we planning to launch the same?

Arun Kumar: We have planned for the European and other markets. We are not selling this product in the US.



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Aman Vij: We don't even plan to enter US for this product?

Arun Kumar: No.

Moderator: That was the last question. I would now like to hand the conference over to the management for closing comments. Over to you, sir.

Arun Kumar: Thank you all for joining us today and thank you for your support in all these quarters. And if you have any questions, please do not hesitate to call us or Abhishek or write to us; we would be very happy to address them. Thank you all. Have a good evening.

Moderator: On behalf of Strides Pharma Science Limited, that concludes this conference. Thank you for joining us. You may now disconnect your lines.
