"Strides Arcolab's CY2010 Post Results Conference Call"

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MODERATORS: **MR. ARUN KUMAR – VICE CHAIRMAN & MANAGING DIRECTOR, STRIDES ARCOLAB**
MR. TS RANGAN – GROUP CFO, STRIDES ARCOLAB
MR. AJAY SINGH – HEAD, INVESTOR RELATIONS. STRIDES ARCOLAB
MR. NITIN AGGARWAL – ANALYST, IDFC SECURITIES

Moderator Ladies and gentlemen, good day and welcome to the Strides Arcolab CY2010 Post-Results Conference Call hosted by IDFC Securities Limited. As a reminder, for the duration of this conference, all participants' lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on your touchtone telephone. Please note that this conference is being recorded.

At this time I would like to hand the conference over to Mr. Nitin Aggarwal of IDFC Securities Limited. Thank you and over to you sir.

Nitin Aggarwal Hi good afternoon everyone and a very warm welcome to Strides Arcolab for CY'10 post-results conference call. On the call today representing the management, we have Mr. Arun Kumar, Vice Chairman and Managing Director. Mr. T S Rangan, Group CFO and Mr. Ajay Singh. I hand over the call to Strides management to take it forward. Please go ahead sir.

Arun Kumar Good afternoon to everybody. This is Arun on behalf of Strides I thank you all for taking time out today to participate in this post-results call.

Before I start I just want to give a quick update on results. Strides in February 2010 and later in March 2010 issued guidance to the market and I am delighted to mention the two key parameters in the guidance namely, top line and EBITDA, we exceeded on both **counts** if you consider the fact that the top line does not include close to Rs. 30 crores of top line from the deal which was not consolidated due to regulatory reasons and delays in getting regulatory approvals. Our EBITDA margin exceeded. And during our investor calls and conference calls, press release to individual investors and investor needs, we also indicated that our R&D income would be in the vicinity of between $60 and $70 million. And I am delighted that on all these three counts we have exceeded the guidance.

Specifically, the year has been game changing for Strides. It's been an important year in terms of growth; growth more specifically in key target markets, namely, North America, where we have doubled our sales from 6% of total turnover to 15%. Continued focus into key markets like **Australasia**, where we have a very large presence and that business continues to grow very well with improved performances on the EBITDA front. We also reentered the Latin American market and we had a good beginning in terms of our operations and integration strategies there. Africa continues to be an important market for Strides and it is of great importance that this has grown well for Strides, we have improved our position in the African market including improved growth in profits.

More importantly, our Specialties business has grown and has actually exceeded the guidance, and it continues to be an important part of our future business strategies as we can reflect in the 2011 guidance, also where I will touch upon soon.

EBITDA from the Specialties division contributed 57% of the total EBITDA the company earned, although the Specialties division only delivered 39% of the turnover. That is changing at the Specialties business ramp ups are far superior than the Pharmaceutical division and we believe that the catch up game will happen in the next couple of years.

In terms of regulatory approvals, we have had a good year with filings; we have now a total of 151 ANDA filings with FDA, 28 filings in the US in 2010, and 22 approvals, which also takes our total approvals to 53, 33 of them in injectables.

We continue to have traction in various other markets. We started a strong filing of dossiers in Europe with over 20 filings in the European Union alone, and in another regulated markets also, the filings and approvals have been strong.

During the year we expanded our partnership with Pfizer to include newer territories and geographies that includes Japan, Europe and parts of **Australasia**. And of course on 31st of December we also sold a portfolio of products of our Akorn-Strides JV to Pfizer through a bidding process which was acquired by Pfizer.

And we believe there is traction in our US and North American businesses. And we also received our first Soft Gelatin product approval for Ergocalciferol which is a limited competition product and I am delighted to let you know that we have already taken over 12% of the market in the first quarter of our launch of this product. Although a small molecule we believe that this will be the beginning of multiple approvals that we are expecting in the Soft Gelatin space.

So in all the businesses we have tracked well. We also launched our India operations for Specialty injectables through Ray of Life and we had a good first year of success in the Indian markets by having converted key hospitals to prescribe our drugs.

Now, before I let my colleague Rangan give you an overview on the finances, I would also like to touch upon and emphasize the guidance for 2011. The company is forecasting a revenue growth of 25% to Rs. 2,200 crores. This is in spite of almost Rs. 100 crores reduction in guidance for R&D licensing income as we believe that a later stage licensing income is commercially more beneficial for the company. Going forward that's the model Strides will adopt.

We are also pleased to guide that the Specialties business will be in the vicinity of Rs. 1,000 crores. This has grown from Rs. 300 crores in 2009. As you can see there has been rapid growth and 45% growth with an EBITDA range of 28% to 30%.

We believe that the Pharmaceutical business will achieve sales of Rs. 1,200 crores and EBITDA will range between Rs. 160 to Rs. 180 crores.

Like I said we believe that our R&D licensing income will reduce from Rs. **352** crores to about Rs. 250 to Rs. 270 crores.

Rangan will touch base upon the importance of our guidance on interest and corporate tax. These have been significant events for our 2010 numbers and therefore, we have guided the market for the first time, on interest cap and an effective corporate rate so that below the EBITDA details can better be understood and articulated.

At this stage I would request Rangan, our Group CFO to take you through the highlights of the year in terms of financial **performance**.

T S Rangan Yeah. Thanks, Arun. What we will do is that very quickly we will look at Q4 as well as the YTD so that it will provide clarity and feel free to ask in case of any clarifications required.

For the quarter we have reported 16% growth in revenue, that is Rs. 469.90 crores against previous score of Q4 of 2009 of Rs. 406 crores. For the year, like Arun said that, we have reported 33% growth, exceeded the EBITDA guidance in spite of not consolidating the top line. Here I would like to emphasize that one major thing is that while we have not consolidated the top line of Rs. 30 crores of Campos, company on a prudent basis absorbed all expenses, like for example, all the management fee of the Brazilian operations are close to about Rs. 7 crores, we have taken it in the Q4 '10, while the top line has not been done on a prudent basis, we absorbed all the expenses.

EBITDA for the quarter is Rs. 91.50 crores as against Rs. 83.70 crores, 9% growth, for the year, Rs. 396.30 crores vis-à-vis the Rs. 210.50 crores previous year, representing about 88% of growth.

So, below the EBITDA, I would like to touch upon two important decisions company has taken on a prudent basis because consistently in all our presentation we said that we give a lot of importance to the governance and accounting practices. Accordingly, Institute of Chartered Accountants of India, on 11th of February 2010, announced a pronouncement in terms of the Accounting Standard – 30. Till last year Accounting Standard – 30 was recommendary in nature and Strides fully adopted this particular standard, whereas in the month of February

2010, what institute said is that, since the standard is recommendary in nature, it has to align with the mandatory standards like Accounting Standard 11, which talks about the reinstatement of exchange gain and loss. Accounting Standard – 13 which is about the investment.

So what happened is that by implementing the standard the exceptional expense has increased by Rs. 16 crores. This is very important for you to understand that we said that we will be conservative and we will fully comply with the standard. While the Rs. 16 crores is for the entire year, it has to be accounted in Q4 because the standard mandated retrospective, so accordingly Rs. 16 crores of expenses have been accounted as 'exceptional items' as per the AS **13** new pronouncement.

Second one is that so if you consider that the PBT for the quarter is Rs. 25.70 crores and adjusted PBT will be about Rs. 43.7 crores vis-à-vis Rs. 63.7 crores; And for the year is Rs. 186.4 crores against Rs. 142.9 crores represents a 30% grpwtj.

So I already informed that we took the management fee close to about Rs. 7 crores in the Brazilian thing for the entire year in Q4. Second is that we also talked about the Accounting Standard alignment which is about Rs. 16 crores, that also flown into my Q4. And after the PBT, what the company has also done is that ever since it's announced a deal with the Pfizer Akorn-Strides, it also initiated a significant tax planning exercise. Accordingly, we went through a comprehensive restructuring, wherein that the ownership of the JV has actually moved from Strides in India to Strides Inc in USA. This is a part of the planning process. This particular one is being implemented so again on a very conservative basis, on a prudent basis, what company has done is that even though there is a MAT credit available to the extent of Rs. 12 crores, that has not been brought into the financials because we thought that we will be better off bringing all the tax-related issues post completion of the tax planning exercise. In fact, this particular position of the company has been well appreciated by Deloitte and has been mentioned as part of our board process. So thereby the provision for the quarter is Rs. 18.3 crores, we could have actually made it to Rs. 6.3 crores, but we thought that it's important that since the structuring is taking place and to avail the MAT credit we need to demonstrate a virtual certainty and we said that when we are going through a structure on a prudent basis we said we will not consider that.

So for the year provision for tax is Rs. 45.2 crores, so if you look at the adjusted PAT, it will be about Rs. 30.3 crores which is on par with any quarter run rate. For the year, the PAT is Rs. 141.2 crores, that is against Rs. 121 Crores, which represents 17% growth before minority interest. After the minority interest we reported about Rs. 122.5 crores for the year as against Rs. 105 crores representing the 12% growth.

So what we are trying to do is that in Q4 we have taken one-time impact to the extent of more than Rs. 35 crores, which are not really representing the Q4, but it is for the entire year. Yeah, these are all non-cash items except the first one the management fee. Do you have any specific questions?

T S Rangan On the P&L side.

Moderator We have the first question from the line of Krudent Cheda from Value Quest Research. Please go ahead.

Krudent Cheda The top line of Rs. 1696 crores, how much of licensing income is included in that?

T S Rangan We have Rs. 362 crores as the licensing income.

Krudent Cheda That in included within Rs. 1,695 crores?

T S Rangan Yes.

Krudent Cheda And, in the Rs. 2,200 crores guidance that you gave, does it include the licensing income, or is it…?

T S Rangan Yeah, Rs. 250 crores to Rs. 270 crores is the guidance range for licensing income.

Krudent Cheda Okay, sir. All right, I will come back if I have any questions. Thank you.

Moderator The next question is from the line of Rahul Kothari from DNB Nor. Please go ahead.

Rahul Kothari I just wanted to check on the interest part, how much is related to the FCCBs and **otherwise**?

T S Rangan Yeah, it's closely about Rs. 15 crores related to non-cash interest, this has been also captured in our press release.

Rahul Kothari Okay, which is related to the FCCB?

T S Rangan Yeah, **YPM reached it Rahul Kothari** Okay. And what is the cost of that currently from **that you** have in the balance sheet?

T S Rangan 11% average.

Rahul Kothari Okay. And lastly, what kind of tax rate would you --?

T S Rangan Like, for example, we said that currently we are at 24% tax rate, having said that in the guidance like earlier Arun explained, since we have always initiated a very comprehensive tax planning exercise, we will cap it at 21%.

Rahul Kothari Okay. Thank you.

Moderator Thank you. The next is from the line of Amit Shah from Motilal Oswal. Please go ahead.

Amit Shah Arun, just a question on this Pharmaceutical business. See, for the full year the business has grown 13%, in which Australia, Africa business has done pretty well. The remaining two businesses that is the ATM business, ARV, tuberculosis and malaria business and the Indian branded generic business doesn't seem to have done too well. So, any reason for that and what is the outlook going forward?

Arun See, consciously, we are downsizing our ATM business. The reason is that there are significant pricing pressures, we are not a fully integrated API to formulations player and we believe that our capacities are better utilized for more profitable businesses. So we will be in very selective areas, we are not completely exiting that business but we are not planning to grow the business as we used to in the many years far. As far as the Indian business is concerned there has been de-growth and the de-growth of the Indian business is primarily because we cleaned up the pipeline stock completely. So in the first three, four months, we cleaned our pipeline stocks and we took reduction in sales in the interest of the quality of the business. So we have brought down our debtor days less than 30 days, we got out of market which does not make sense in terms of critical sites. Going on quarter gives us comfort that we will double the business from the last year. The going on quarter is very solid, and the first two months of this year is very solid. So we took certain action in 2010 since the business is very small, we dropped about Rs. 15 crores of top line, but we improved dramatically the quality of business.

Amit Shah Okay. So CY11, you expect the business to double from the –

Arun Branded India business. But don't forget it's a very small way.

Amit Shah Yeah. That's true sir. So if I look at it, sir, as you said you will be consciously reducing the ATM business, so the growth guidance you have given about Rs. 1,200 crores revenue, so would Australia and Africa business drive the growth entirely?

Arun Yeah, mainly.

Amit Shah Okay. That's right.

Arun Yeah, it has grown 26% last year whereas the Australian market alone is growing in single digit, we have grown that market 26% and we believe growth will continue to be strong in that **Malaysia 19:13**.

Amit Shah Right. Now sir, just couple of questions on the Specialty side. So in CY11 how much business do we expect from our marketing partners, that is Pfizer and GSK, approximately?

Arun Well we don't have a policy of mentioning customer wise sales. Our partnership businesses to various partners will be approximately 25% of our guidance.

Amit Shah Okay, fine. Thanks a lot, sir. I will join back in the queue.

Moderator: Thank you. The next question is from the line of Kartik Mehta from Daiwa Capital. Please go ahead.

Kartik Mehta Taking cue from the previous question, the existing US business, without any new sales happening from the products which would be approved, seems to be increasing substantially. If you can throw some light on products like Vancomycin and some other products, as you mentioned in your opening remarks, which you have got approval-, for the injectables as well as the non-injectables particularly to the US markets, where you have got ANDA approvals?

Arun Kumar Yeah. First of all just to give a recap, we have three facilities which are US FDA approved. Only one facility is currently servicing the US market. But in the last one year we managed to move out all non-US businesses from our plant to other newer facilities, which are approved by European agency. So we moved all our non-US business dedicating our first plant to 100% US focus, that has allowed us to introduce additional products into the market and you know that we have 33 products approved, but we commercialized only five in the first half of last year and by the end of the year we have commercialized a total of nine additional products. And we now have the ability to introduce another four to five products in the next two quarters, because we completely moved our non-US products away from this facility. So that's one of the key reasons why we have been able to ramp up. Having said that the industry is currently facing an acute shortage of products, so obviously a product like Vancomycin, where we are a very strong player is under shortage, additional shortages are being announced on these products. So we have been able to ramp up by operational efficiencies and improveour productivity from our existing plants. So that's the key reason why growth will continue to be strong from our existing plants and we believe that out of the two other facilities which are already FDA approved we will have some additional products that would be approved within this year which will allow us to ramp up sales further.

Kartik Mehta Yeah. So for the products which have been approved for the US market and which have not been launched, I would not want a customer wise breakup but they seem to be relatively in some niche areas. Can you share an overall outlook in terms of a total addressable market, because all these are approved and I am assuming they would eventually be launched by **their 23:20** existing…?

Arun Kumar Yeah the total addressable value for the products that are approved, for all the 33 products is \$1.5 billion. You see, as you understand Kartik, we have contractual obligations with GPOs, and we are not introducing new products, because we cannot default on any of the GPO contracts. On our existing products like Vancomycin itself, we are seeing demand doubling. We did \$15 million last year with limited capacity. We have seen demand doubling on a product like Vancomycin. So the niche products are very much there, but they will not materialize as a product like Vancomycin.

Kartik Mehta Okay. So now for this particular year, I am keen to know for the non-injectable approvals in the US market. Do you think that the shortages of the products would continue and how geared up are you because there is an approval which is on the line and do you think that you would be the only company who can take, maybe-, advantage, if I take at least the example of actually Vancomycin where the price erosion has not been high at all?

Arun Kumar There has been no price erosion at all for Vancomycin. In fact, the Vancomycin ASP has actually increased. So that's a good example of our product selection. But having said this, there is currently an acute shortage of capacities because almost all major players have multiple challenges from a manufacturing and regulatory standpoint. We have guided that some of our new facility; we believe strongly that we will be selling products in the beginning of H2 of this year. And we are very confident about that event. Now if that happens, do we have enough capacity to meet demand? The answer is, yes. How many products do we want to sell ourselves? It is another challenge because we have taken a conscious decision that in this era where there is acute shortage of capacity, we will not be tempted by a quick contract manufacturing opportunity. At the moment, all the major players are approaching us for contract manufacturing opportunities and we are not in that business. So it's a little too early to say, but I think it would be an important H2 for Strides, although H1 will still be very robust because of the strategies I mentioned to you earlier being initiated. But I think it would be more appropriate if we touch base again in about two to three months when we can give you a much higher visibility in terms of what kind of volumes that we can service the market. At the moment, our existing facilities running at over 100% capacity utilization for the US.

Kartik Mehta Okay, thanks.

Moderator Thank you. The next question is from the line of Hitesh Mahida from Marwadi Shares. Please go ahead.

Hitesh Mahida Sir, there are a few queries; the geography wise breakup which you have mentioned in your presentation, is it excluding licensing income or does it include the licensing income?

Arun Kumar It excludes licensing income, it's purely operational.

Hitesh Mahida It excludes and does it exclude tender business as well?

Arun Kumar We don't do tender business.

Hitesh Mahida ARV business?

Arun Kumar Yeah, it does include ARV, but our ARV business is less than 10% of our turnover.

Hitesh Mahida Okay sir. And how much was the expense from Campos this year?

T S Rangan It's about close to Rs. 7 crores.

Arun Kumar Rs. 7 crores is what was our expenses for the two months that we took control of the operation.

Hitesh Mahida Okay sir. But if I look at your other expenses, quarter-on-quarter it has gone up from Rs. 59 crores to almost Rs. 97 crores. And also the employee cost has gone up by around Rs. 10 crores, from Rs. 54 crores to Rs. 64 crores.

Arun Kumar Correct.

T.S. Rangan Yeah. The employee cost is basically I'm sure you are aware of it is a year end, we have also done the actuarial valuation of leave encashment, gratuity and, you know that, in the beginning of the year the performance incentive judgment will not be correct actually, having done that, so we have taken care of all of those things and we recomputed and the employee costs have gone up. Otherwise, overall if you look at it, there are one-timers, like, for example, as I mentioned earlier that management fee of Campos, actually that has been included, actuarial evaluation another 4 crore that has been included. There is a service tax element we are talking about. As part of our Australian restructuring distribution thing, they have also closed a warehouse in Sydney that costed about Rs. 3 crores. Then we have also gone through the year-end financials. There are amortizations of the deferred revenue expenditure and we have also, you must be aware of it, given our firm offer for privatization of Australasian business actually, Ascent Pharma, so we took that expense also.

Hitesh Mahida Okay, that's been the reason for increasing...

T S Rangan These are all the audited things and we have ensured that and we **adjusted everything 29:10**.

Hitesh Mahida Okay. And last time you were talking about immunosuppressants launches in US. When can we expect that?

Arun Kumar It is launched this quarter.

Hitesh Mahida Okay it has been launched this quarter. And as far controlled substance is concerned, I mean, it is again a very niche segment and the Poland facilities I think is almost ready?

Arun Kumar Yes it is commercialized already. The products have just started selling in specific markets in Europe, and it will take us about a year or two before we get all the **27 29:46** markets.

Hitesh Mahida Okay. What sort of sales can we expect from this facility?

Arun Kumar In the first stage, it's going to be very small, because it still is going through regulatory processes; we have some national approvals in certain markets, which we are servicing. And a larger approval process is still undergoing, it's taking place, so we don't expect to have a very significant business at least one to two years from now.

Hitesh Mahida Okay. As far as selling of ANDA of Akorn-Strides to Pfizer is concerned, I think it was $28.3 million. So that's been included in the top line I think.

T S Rangan No, it will be done in Q2, as per the contract.

Hitesh Mahida Okay, it will be done in Q2; it's not been done this year.

Arun Kumar No half….

T S Rangan Yeah, see the contract has two portions, what we call it as an initial product and the final one. So inline with the recommendation of the auditors 50% has already been consolidated, 50% will be done in Q2 and the final transfer will take place.

Arun Kumar The official transfer to Pfizer will happen only from 1st of April.

Hitesh Mahida Okay. And is there any cost incurred on this selling of.

T S Rangan Not on the cost, but I just want to recollect that while we have taken the 50% of revenue, we have taken the 100% of tax in this year itself, again on a very conservative basis.

Hitesh Mahida Okay, thanks a lot.

Moderator: Thank you. The next question is a follow-up from the line of Amit Shah from Motilal Oswal. Please go ahead.

Amit Shah Sir, this Bangalore facility, sterile facility and oncology facility, so have you already got the US FDA approval for those, or they are undergoing the process?

Arun Kumar They are undergoing the process, and that is why my guidance clearly mandates that we believe that we will be in a position to commercialize on this facility, latest beginning of H2.

Amit Shah That's right. Now just a couple of questions on financials. Mr. Rangan, if you could tell us that out of the total remaining obligation payable to Aspen, how much is still remaining?

T S Rangan As of date we have cleared everything. As of 31st of December, we had about 33 million. See, from our balance sheet we have the cash for Rs. 33 million. We paid the obligation.

Amit Shah Right. And in the balance sheet, I see loans and advances have shot up quite dramatically year-on-year. So any particular reason?

T S Rangan Not year-on-year, only this year, what we have done is that, its part of this year, we have gone through the LATAM restructuring. If you look at the 2009 balance sheet under the 'Investments and Securities' you can see that there are about Rs. **313** crores of investment in staffs more. We said that it's a part of the Campos consideration. So this has been considered as the consideration for the Campos facility and related business along the 65 million which we paid as a net consideration for the facility, both of then have been shown under 'Loans and Advances' because we have not obtained the ANVISA approval. Post approval of the ANVISA approval, this will be moved to the asset. That's the only reason.

Amit Shah Right. And you said something about this higher tax rate in the last quarter. Sir could you please repeat it for my understanding? I did not get it.

T S Rangan What we said is that, there is an opportunity that we could have taken a MAT credit of Rs. 12 crores, not an opportunity, it is available in the books. We have initiated the tax planning exercise and we feel that this will be completed in 2011 on a prudent basis; we did not take that credit in the books. Credit will be available to us next year.

Amit Shah Okay fine, and the current debt level, going forward; do you expect that debt levels to reduce?

T S Rangan It will stay as it is, because having met all our obligations, it will not increase.

Amit Shah It will not increase?

T S Rangan In the sense significantly.

Arun Kumar There would not be any significant increase or decrease in the debt level.

T S Rangan For example, when we presented the September 30th net debt was Rs. 1,628 crores and now it's Rs. 1671 Corores

Arun Kumar So we are seeing a small range.

T S Rangan Yes. In spite of meeting obligation close to about Rs. 670 crores in Q4.

Amit Shah Right and what would be CapEx guidance for CY11?

Arun Kumar It's only a maintenance CapEx group. The group will not spend over $10 million for maintenance CapEx.

Amit Shah Okay fine, thanks a lot sir. That's all from my side.

Moderator: Thank you. The next question is a follow-up from the line of Kaushik Pal from Kotak. Please go ahead.

Kaushik Pal Just want to understand this minority interest that we have in CY10, if you take Ascent Private, will it reduce very sharply?

Arun Kumar Yeah, we will get from 60% to 90% ownership.

Kaushik Pal So can we assume that, if not all at least; most of the minority interest is on account of...

T S Rangan Yeah it is...

Arun Kumar It is mainly on account of Ascent.

Kaushik Pal Okay, thanks.

Moderator: Ladies and gentlemen that was the last question. I would now like to hand the floor back to Mr. Nitin Aggarwal for closing comments. Please go ahead.

Nitin Aggarwal Thanks, everyone for taking time out and participating the call. And we also thank you and Strides team also for participating and to handle all the questions.

Arun Kumar Yeah thanks, Nitin for facilitating.

T S Rangan Thank you.

Moderator Thank you gentlemen of the management. Thank you Mr. Aggarwal. Ladies and gentlemen, on behalf of IDFC Securities Limited, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.