



“Strides Arcolab Limited’s Q4 CY13 Earnings
Conference Call”

February 7, 2014



MANAGEMENT **MR. ARUN KUMAR – FOUNDER & GROUP CEO**
MR. BADREE KOMANDUR – CFO

MODERATOR **MR. NITIN AGARWAL – ANALYST, IDFC SECURITIES**

Moderator: Ladies and Gentlemen, Good Day and Welcome to the Strides Arcolab Limited Q4 CY13 Earnings Conference Call hosted by IDFC Securities Limited. As a reminder all participants' lines will be in a 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 telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Nitin Agarwal of IDFC Securities. Thank you. And over to you Sir.

Nitin Agarwal: Good afternoon, everyone, and a very warm welcome to Strides Arcolab's Q4 CY13 Post Results Conference Call hosted by IDFC Securities. On the call today we have representing Strides Arcolab, Mr. Arun Kumar – Founder and Group CEO, and Mr. Badree Komandur – CFO. I hand over the call to Strides management to take it forward from hereon.

Arun Kumar: Thank you, Nitin, thank you for hosting us again. Good evening, friends, and thank you for joining into the call. We today announced our Q4 results, and as we guided earlier, we have extended the financial year by another three months to be in compliance with the new guidelines where the financial year should start in April. Accordingly, to ensure the continuity of guidance, we have guided an additional quarter for the year, which will be five quarters this financial year. That is a slightly better quarter in terms of EBITDA growth compared to the previous quarters.

Before I start, as everybody knows, we completed the deal with Mylan successfully, and we have already addressed issues there, and distributed the dividends, paid our taxes and the debts, and the company as a consequence is debt-free as we speak, as we have more cash than our working capital debt. This has also resulted in an upgrade of our ratings from BBB+ to an A+ by Fitch recently. I am also pleased to report a very strong quarter for Q4, which helped us meet revenue guidance and our EBITDA guidance. Net of FOREX losses - EBITDA is slightly higher at Rs.223 crores compared to the Rs.201 crores that we reported. Revenues for the quarter was Rs.326 crores with an EBITDA of Rs.60 crores, and we believe that the company will be able to repeat the EBITDA performance for the current quarter. We have a strong order book driven by a good launch of the Anti-malarial product where we received WHO approvals recently. We have strong offtakes in that business, and the rest of the business is also doing well.

We have commenced very strong investments in our R&D for our Pharmaceuticals business, and although you would see that there is no new filings in the Pharmaceuticals business, obviously this is because of the time it takes to develop the products as we de-focus from the Injectable business, we have ramped up staffing in R&D, in Pharma, and we believe that in the financial year 2014, we will get to a 20-odd filing regime followed by a more aggressive uptake in regulatory filings with the US FDA.

Key product approvals in the US are still not forthcoming -- this has been disappointing for us. Revenues and guidance have been met in spite of that. But, we do expect approvals soon hopefully, we should have further swing in our numbers, and a much more robust guidance when we finish this quarter and report for the next year.

The biotech business is going steady; we have commenced a new R&D center in the outskirts of Bangalore, and we have moved our staff into this new center, and we are very excited about the opportunities that we have here. Obviously, it is at a very early stage. We recently announced a long-term arrangement with a German company for a worldwide development of a protein molecule, mainly focusing on the Ophthalmics. We believe Stelis Biopharma is a few years away before it gets to a critical juncture in this business, but we are very confident with the positive steps that the company has taken in that direction.

At this stage there is no more introductory comments that I have to make, and I will be more than happy to take questions and then address some of the issues that may come up during these questions. Thank you.

Moderator: Ladies and Gentlemen, we will now begin the question-and-answer session. We have the first question from the line of Hitesh Mahida from KR Choksey Securities. Please go ahead.

Hitesh Mahida: First thing sir, is there licensing income component in this Rs.1,035 crores from our Global Pharma business?

Arun Kumar: No.

Hitesh Mahida: No, so the entire EBITDA of Rs.201 crores is from our base business?

Arun Kumar: Yes.

Hitesh Mahida: And secondly, Sir, can you throw some color on this 18 ANDAs which are pending, how many of these will be in Soft Gel particularly since we want to become a dominant player in the Soft Gel market going ahead? And is there any other segments in the US market, which we are targeting?

Arun Kumar: There are about 5 filings in the Soft Gelatin space out of the 18 pending, and the new filings are predominantly in the topical space, so it is Ointments and Creams out of our Italian subsidiary.

Hitesh Mahida: Basically, it is the Soft Gels and the Derma space what we are targeting in the US right now? Sir, any update on the contingent payment of USD 250 million which we are going to receive from Mylan?

- Arun Kumar:** There is no update from our previous call. We explained during that call that we do not expect a resolution or reinspection of the FDA before Q2 of this year that is when we expect the FDA to come back for the inspection, and upon that we would have more news on the contingent payment. At this time we are very confident that everything is on track. We are working very closely with the Mylan management, and there is enough focus there as this is a large capacity plant and we are working together to find quick solutions around the issue that has been raised. So, no change in the previous guidance that Q2 of 2014 we will be able to guide you better.
- Hitesh Mahida:** And Sir, update on Malaysian facility. We were expected to start commercial operations at the start of 2015. So are we on track to achieve that?
- Arun Kumar:** The Malaysian facility was supposed to be completed by end of 2015, and commercial revenues were expected in 2016. We have not yet started the construction of the facility, currently it is in the tender process, but we still believe that the facility will be on stream by middle of 2015 for validation and commercial production by the end of 2015.
- Hitesh Mahida:** So the first launches will take place from CY16 only?
- Arun Kumar:** That is right.
- Hitesh Mahida:** And Sir, can you just help us explain understand this nature of FOREX loss? We have about Rs.22 crores FOREX loss is what we are seeing
- Badree Komandur:** These are some of the working capital facilities taken in the foreign currency that is the packing credit, so these are all the losses which are accounted because of the Rupee depreciation.
- Hitesh Mahida:** Sir, other expenses was very high on standalone basis during the quarter?
- Badree Komandur:** There are three things which has contributed to the Other Expenses -- one is, in terms of if you see our revenue, it has increased and correspondingly the freight cost has increased during this quarter. The second one is in terms of the exchanges getting classified here. And the third one is the taxes which are of a routine nature, one-time taxes had to be paid, not in the nature of income tax. So these are all the taxes which are pertaining to some service tax and other things. So these are the three components which has contributed to that increase.
- Moderator:** Thank you. The next question if from the line of Anil Shah from Birla Mutual Fund, please go ahead.
- Anil Shah:** Congratulations Sir on a good quarter. Just two questions sir. One, the guidance you have given for the next quarter, obviously your year ending is now going to shift to the 15 months, I appreciate that hence you have just given a quarter guidance, is that for the standalone or the consolidated?

- Arun Kumar:** It is for the consolidated retained business.
- Anil Shah:** Because you are guiding for revenue of Rs.280 crores, but in this quarter we have done Rs.326 crores?
- Arun Kumar:** Correct, but if our institutional business book is high, then they add to significant top line revenues not necessary to EBITDA, but you will notice that the EBITDA is the same at this level.
- Anil Shah:** It is more seasonal right?
- Arun Kumar:** It is to do with how large your institutional book is.
- Anil Shah:** You did mention that there has been a delay from the US FDA on the product approvals. I was wondering if it is related to any US FDA inspections for the plants which have yet to be done and hence the delay, if you could throw some light on that?
- Arun Kumar:** You are right. The pharmaceutical facility was recently inspected by the FDA and we expect a compliance certification from the agency in the next maximum 6 to 8 weeks and that would then start the flow of product approvals, it was a good inspection.
- Anil Shah:** There was no major observations or as such?
- Arun Kumar:** There weren't any.
- Anil Shah:** Just last questions, on our Italian facility, we have got clearances from the US FDA. When do we start seeing some launches there? And what kind of contribution can we see next year on that particular facility?
- Arun Kumar:** We cannot give you a granularity in terms of what it will do for each plant, we are probably expecting one product approval from the Italian facility very soon.
- Anil Shah:** Then we could possibly launch that for next year?
- Arun Kumar:** Yes.
- Moderator:** Thank you. The next question is from the line of Karthik Mehta from ICICI Securities, please go ahead.
- Karthik Mehta:** Just two things, if you could share how many products should one build in that you will file in the next year, now it will be a financial year, so FY15? And for the Biotech business, what would be the expense base, because that would not be yielding any revenue, can you give some ballpark number for that because that will also be included in your operating expenses?

- Arun Kumar:** For the next financial year, we expect filings to be about 20 odd for the US market and about 10 odd filings for the European market. Obviously, there are filings for other reg markets, but they are not as material as both US and Europe are concerned. On the Biotech, currently we spend close to about \$6 to 7 million a year in terms of expenses, that will obviously go up a little more, at this time I will not be able to tell you exactly how much more that will go up because we are still waiting for some clinical trial approvals, so we are wondering if some of these studies are going to be shifted outside of India given the current environment. So maybe next quarter we can guide you a little better on the actual spend, but currently we spend about \$6 odd million.
- Karthik Mehta:** I know that you will not share on any of the specifics, but anything you would want to comment on Combivir Progras, Arun?
- Arun Kumar:** It is all dependent on the plant inspection. We did have a good outcome out of that. We are just waiting to be up on the FDA side, which we hope it will come up soon, and then we expect the flow of approvals. These two products that you are referring to are key products in our portfolio and we are hopeful that we will get approvals very soon, as soon as the official plant approval status comes.
- Moderator:** The next question is from the line of Saravanan Viswanathan from Unify Capital, please go ahead.
- Saravanan Viswanathan:** In the last call you had indicated CAPEX spending of close to \$50 million. Just wanted to have an update on the same -- whether that figure holds good as we move into the new financial year?
- Arun Kumar:** The \$50 million you are referring to post-Agila transaction?
- Saravanan Viswanathan:** That is right.
- Arun Kumar:** That was related to the Agila transaction. So we do not have \$50 million spend for the remaining business. There were certain commitments on CAPEX that we were supposed to do as per the transaction, and that was the number that we had guided. The legacy retained business -- the CAPEX is only about \$10 million dollars a year max.
- Saravanan Viswanathan:** And could I have the consolidated revenue number for Q4 FY12. You have given the EBITDA number as Rs.28 crores in Q4 FY12.
- Arun Kumar:** The top line was Rs.284 crores.
- Moderator:** Thank you. The next question is a follow-up from the line of Anil Shah from Birla Mutual Fund, please go ahead.

Anil Shah: Just a question. You talked about 20 filings in the US and 10 filings in Europe. I was wondering again, what would be the strategy in terms of which products are we really looking to file for? In the past we have been very selective in terms of the products. They have not been meaty products and neither have they been very large ones, but where do you think there was a nice niche and we are likely to make some good margins and EBITDA, if you could tell us a bit on the strategy part in terms of going forward now that the focus is going to be on legacy, what is that we are really looking to do in the US and Europe?

Arun Kumar: The niche does not change, the strategy does not change, the difficult to make complicated manufacturing technologies or sourcing up APIs. It is just that now that we do not have the focus in Injectables where almost 90% of our R&D efforts were in Injectables. We are now ramping up the number of products that we have identified and filing in the Pharmaceutical space. So, these are not blockbusters, they are very-very small niche products where there is only one or two generic players, price erosion is smaller as we are experiencing in Vancomycin where we have still 35% market share even on the second year of launch and a good price point with large margins. So those kinds of products continue. It is just that we have identified a lot more products, because now we have the bandwidth and the manpower to do that many more products in R&D.

Saravanan Viswanathan: And again any number that you would like to put in terms of what kind of R&D spend as a percentage of sales that you would like to go up to because as you rightly mentioned the entire focus has all along been Injectables and now that once coming back on this and would like grow at a steady pace, but at the same time I was just wondering if you have a number in mind there in terms of ...?

Arun Kumar: The budget for the next financial year is about 5.5% to 6% of the consolidated sale, that is what we will do and that will go up, and that does not include the Biotech spend, which is a fairly different number. So we are looking at around 5.5% of sales as our R&D spend going forward.

Moderator: The next question is a follow-up from the line of Karthik Mehta from ICICI Securities, please go ahead.

Karthik Mehta: Just to maybe emphasize this, how would be in terms of capacity, assuming that we have almost about 18 ANDAs pending approval and 47 filings until date, I am just referring to the US side, and we will also be filing, at some point of time would you feel that the capacity for the US market needs to be added? And also more so that would there be any thought to file any more Injectables and set up a new Injectables in the future?

Arun Kumar: I think we are done with Injectables, we have a non-compete, and we cannot be in the business. Post that, to get back to that business, I think there is just too much capacity being built up in India and we do not think post our non-compete period lapsing Injectables would be a niche

that we want to work in. Coming to capacities, our regulated market facilities currently operating at around 60% capacity utilization with Soft Gelatins even lower than that. So there is very incremental CAPEX that we need to add in terms of equipments to meet a much larger demand. So, we do not see any capacity constraints.

Karthik Mehta:

Arun, a relatively longer term question would be that if I have to look at your existing operations, and if I have to build any value for Biotech, and so you have mentioned as your starting remark that you are a few years away to having anything in Biopharma, you have not built any capacity there and I am sure you do not want to build also, when should one build in some value by way of outlicensing or some overall sales that you could get from the non-regulated markets, assuming that you would first be in and around the Malaysian markets, when can we see that, would it be after 2 years or would it be after 3 years?

Arun Kumar:

There are two parts to our Biotech business -- one is, we have already signed up with a big pharma, it is not in the public domain -- and this is not the appropriate time for that discussion -- where we will have a manufacturing R&D partnership. You are aware that we have done similar kind of arrangements into this business, it is not the same partner that is all I can tell you. It is a fairly significant arrangement and that revenues will start kicking in as early as 2016. Because it is going to be an in-licensing arrangement for us to have marketing rights in various emerging markets including a manufacturing arrangement including the reg markets. There would be some revenues coming in by 2016 and that revenues will be significant enough to take care of our operating costs and also the R&D spend that will be required. In our portfolio, we expect licensing income to be definitely a feature of our strategic model and we expect licensing income to take care of R&D spends not the financial year starting April, but the following financial year in 2015-16.

Karthik Mehta:

Would you believe that for the Biotech part to be self sufficient, so FY16 is the year when not much of the cash flows from your Pharma business would be required to fund that, am I right?

Arun Kumar:

You are right.

Karthik Mehta:

So that comes to the question of the US\$75 million, which we have allocated here. So how would you spend that over a period of time -- would it be on some nominal capacity or would it be only on R&D and trials, if you can answer that?

Arun Kumar:

It will be a combination of capacity building and R&D and trials. More than half the total funds dedicated is going towards the manufacturing facility. Incidentally, the amount is not \$75 million, it is \$100 million right from the beginning. We expect \$50 million to go towards the manufacturing capabilities and the balance \$50 million towards the total R&D costs and clinical costs before we believe that our products will get licensing income or revenues to sustain on its own.

- Karthik Mehta:** And we do not have any plans as of now to manufacture anywhere out of Malaysia, as of now, right?
- Arun Kumar:** Yeah.
- Moderator:** Thank you. The next question is a follow-up from the line of Hitesh Mahida from KR Choksey Securities. Please go ahead.
- Hitesh Mahida:** Just wanted to know what would be your strategy going forward as far as the Africa and India branded business is concerned -- are we planning to add more field force at the ground level?
- Arun Kumar:** The interesting or the heartening fact is that Africa and India business has got a fairly good size as a branded business, growth is predominantly coming in from Africa where we are ramping up significantly, our Branded business is doing exceeding well and we are continuing to invest in front end costs including people, we currently have about 100 odd medical reps in Africa. We expect this to get to 500 medical reps in the next three years. So there is a rapid expansion of people and getting into newer markets as soon as we get product registrations and very pleasing numbers we have been able to achieve last year in our Branded business and we expect that to grow even this year. So we are getting into critical size in Africa in the branded business not so in India because as you know we are focusing only in the South of India which is not necessarily a large market, and we are not looking at any inorganic strategies in both these markets. So we are building businesses and we think we will have a very important Branded business in the coming years.
- Hitesh Mahida:** And Sir, as far as our US Formulations business strategy is concerned, we have now almost 47 filings in place. A lot of products we are selling via partnership model. So going forward is there plans to market it ourselves?
- Arun Kumar:** As of 1st of January, if you look at IMS going forward, you will see that Strides has already started its front ending on its own and that is based on the belief that some of the products that will get approvals this year, will be important products to get to critical mass. So we have started our front ending and we are no more partnering products.
- Moderator:** We have the next question as a follow-up from the line of Saravanan Viswanathan from Unify Capital, please go ahead.
- Saravanan Viswanathan:** You were mentioning about the WHO business, Anti-Malarial business, how long is the order cycle, is it a 2-year cycle before the next round of orders kick in or ...?
- Arun Kumar:** It is about 7 or 8 cycles per year, it is more frequent, there are no long-term contracts for this.
- Moderator:** The next question is a follow-up from the line of Karthik Mehta from ICICI Securities, please go ahead.

- Karthik Mehta:** If I heard you right, you said, the new filings, there will be no partnership, you will be on your own, is that what I hear?
- Arun Kumar:** You are right.
- Karthik Mehta:** So in that case you would be employing some more people in the US. Actually, how would that work?
- Arun Kumar:** The first stage of licensing front ending market has been through a contract sales company which we just launched our products on 1st of January and then eventually in about a year or two when we get to critical size we have rights to take that back.
- Karthik Mehta:** Any number that you can put up as to ...?
- Arun Kumar:** Too early Karthik, we are waiting anxiously to get some of the key products that we have discussed approved and then we can proceed.
- Moderator:** Thank you, we have the next question from the line of Deepak Agarwal from Impetus Advisors, please go ahead.
- Deepak Agarwal:** I joined late, wonder if you have given, have you got all the cash from selling of Agila? And where all has it been deployed?
- Arun Kumar:** We have already got all the cash and you need to follow-up our press release of 10th December where all the cash allocation has been notified and please feel free to talk to us on the phone offline if you like more questions.
- Moderator:** Thank you, as we have no further questions, I would like to hand the floor back to Mr. Nitin Agarwal for closing comments.
- Nitin Agarwal:** Arun, any last comments to close the call?
- Arun Kumar:** Thank Nitin, thanks for hosting us, we appreciate everybody's time today, and thank you.
- Nitin Agarwal:** Thanks everyone for taking the time out and participating in the call, and thanks to Strides management team also, thanks a lot guys.
- Moderator:** Thank you gentlemen. Ladies and gentlemen on behalf of IDFC Securities, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.