



Earnings Call Q1 FY 2014-15

July 25, 2014



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



Moderator: Good evening, ladies and gentlemen. I am Varkha Dawar, the moderator of this call. Thank you for standing by and welcome to the Strides Arcolab Earnings Q1FY2014-15 earnings conference call. For the duration of presentation, all participants' line will be in listen-only mode. We will have a Q&A session after the presentation. I would like to now hand over the conference to Mr. Abhishek Singhal. Over to you, sir.

Abhishek Singhal: Yeah. Good evening all. Thanks a lot for joining in to this earnings conference call hosted by us for Strides Arcolab quarter one financial year 2014-15 results. We have with us senior management of Strides and I will hand over the call to Mr. Arun Kumar who will possibly give you an opening statement and then we can open up the call for Q&A. Over to you, sir.

Arun Kumar: Thank you, Abhishek. Thank you for hosting us. And ladies and gentlemen thank you for joining today on our earning's call. My name is Arun. I am the founder and CEO of Strides and I have with me colleagues supporting this call that includes Badree, our CFO, Vikesh who heads Investor Relations and also Mohan Kumar, CEO for pharmaceuticals division. Before I start, let me give you a quick overview of the first quarter. We've had revenues of Rs.260 crores with a slightly weakened EBITDA in total numbers at Rs.54 crores. Nonetheless, the EBITDA margin has been a healthy 21%, which is a 34% growth over the previous year, a 300 basis points increase over the sequential quarter. And the revenue has been in line; EBITDAs have also been in line given the fact that the malarial institution business which is forecasted to be a large part of our future strategies. Although the awards have been made and we are confident about our business looking very good, contractually for Strides or for most companies as we know, as we speak, executable contracts have not yet been placed by the procurement agencies. That obviously has created a lull in our institutional business and cost of a fair amount of a drop, but our regulated market business have started looking up and that's the result of a higher EBITDA.



What I must also say is that in this financial quarter our numbers do not include Rs.12 crores of interest accrued on our investments due to our accounting policy, which means that we can only account for this over the year so that the Rs.12 crores is excluded from our numbers. And if you add that back and are adjusted it back is close to about Rs.30 crores for the quarter. It's been otherwise strategically a good quarter, especially given the fact that we've received some key product approvals in the last few days, so that will have some positive impact in the current quarter and going forward quarters.

Margin improvements has been healthy, like I said, about 300 basis points. We expect that to be improved going forward. We recently announced the acquisition of Raricap, which originally used to be Johnson & Johnson brand, which we acquired from Bafna. We believe that this will be an important product for not only for our global operations in Africa and other emerging markets, but more importantly in India where Raricap has had some great growth in the last couple of quarters since Bafna has acquired this brand and repositioned it as a key haematinic brand.

Africa being a very key part of our growth strategy, for those of you may remember in 2012, we actually divested 20% of our business to PROPARCO for \$12.5 million valuing the business then at around \$65 million. So we decided after much persuasion we were successful in reacquiring this ownership simply because our African business is in a significant growth trajectory and it's a very important business for us, so we like the idea of owning a 100% of the business.

We also announced during the quarter strategic investment of a minority interest in Oncobiologics because this is part of our overall allocation of a \$100 million to be invested in our biotech business. We believe that not only by partnering with other biological companies, but making investments in what we think are extremely smart operators in the space to give us both the financial and technical arbitrage. So we've had a minority interest in oncobiologics, which is a fine biological company based in



New Jersey. And we believe this would be a very important investment for Strides for the group, as we go forward.

It's obviously a little difficult to do comparisons because, as all of you would appreciate. We've sold our Agila business in December, but bulk of our operations including our corporate cost around these spends are all merged with our multiple divisions, so we are not able to give a very specific comparison. So we do not have a comparative number that will only happen from Q4 of this financial year when we will be able to give exact comparative numbers. But, overall, say for institutional business, all our businesses are tracking exceedingly well. Our regulated business revenues were Rs. 109 crores representing 42% of the total revenues. We received three product approvals, Methoxsalen, where we are the only generics player Tacrolimus, there are six other players in Imiquimod, which is a multiplayer product. Nonetheless, all the three products have or will be launched during this quarter. Methoxsalen has already hit the market and we are delighted with the market share we've already got on this product and we believe this will be important step-ups in this and the following quarters.

Institutional business is actually from the sequential quarter significant drop attributable to no sales in our malarial sector and also a slight drop in our HIV business. Revenues were Rs. 73 crores. Emerging market is growing very rapidly and growing very well, especially the African business where we have a significantly increased brand coverage both in terms of new markets, products and people. So we now have close to 200 medical reps in Africa and we will keep on building that franchise in the near term.

The India brands has now started delivering profits. It's Renerve, our flagship brand is tracking Rs.60-crore run rate for the year which will make it a very important brand in the segment that we operate in. The biotech business, in fact, the biotech manufacturing facility in Malaysia is still undergoing unanticipated delays. This is predominantly leading because of contractual closures with the Malaysian government which is a little slow at this time. So we are now anticipating additional delays on this segment.



Obviously we have the cash for this business which has not been invested as yet. And we hope that during this quarter we will be able to resolve our outstanding issues with the Malaysian government and be able to get started with this facility which is now delayed at least for another couple of quarters.

The biotech R&D is going on track. Our R&D spend that is keeping on increasing as we go closer to getting products to animal tox. We will have three products in this financial year which would go into animal toxicity studies. We announced the deferment of the guidance, the company maintains the deferment of the guidance predominantly because we need little more clarity on the institutional business. We hope to have this during this quarter and like we forecasted earlier, we hope that by end of H1 we should be able to start commencing guidance as we used to do before. So that's the high level overview. We have close to Rs.550 odd crores of cash. We are debt free and we are obviously very low on our working capital as our business improves in terms of efficiency. So we are tracking quite well. We are delighted with the new product approval flow which has commenced and we expect couple of more important products to be approved during the next few weeks and I think we would be in a very strong position to track a very healthy growth both in top line and EBITDA and should announce a fairly good outcome when we guide the market in the next quarter or so. Thank you for listening and me and my team will be more than happy to take questions and please free to ask us any questions. And if we are not able to answer some of them, then please feel free to contact Vikesh who will be more than happy to give more detailed answers as required. Thank you. Sorry. Abhishek, I just also would like to talk about before I rather preempt some of the questions. In terms of the holdbacks on the Mylan and Agila transaction, we are at status quo. The situation is under control. Mylan continues to ship products and the facility is becoming an important facility for them. USFDA has not been called in our view for an inspection as yet, but that does not impact the release of a holdback and we believe that during this quarter we should have most of our holdback released. The company maintains at this stage that we have nothing in play and the



holdback is intended after tax to be returned to shareholders. Thank you.

Aditya Khemka:
[Ambit Capital]

Yeah. Hi. Thanks for taking my question. Sir, I know you tried to preempt this, but I still have a couple of questions on the Mylan situation that we have. So if I understand correctly, Mylan is continuing to shift the goods from the facility which is still under a warning letter, right?

Arun Kumar:

Correct.

Aditya Khemka:

Okay. So, sir, what I want to understand is that the amount that we have escrowed on the warning letter is it contingent on the resolution of the warning letter or is the amount contingent on Mylan giving you a clean chit regarding the situation of the facility?

Arun Kumar:

So had the FDA provided a clean chit prior to a certain period which ends in this quarter, we were eligible to get the contingent payment on that date. So the last day by when we should get the money is during this quarter. So if unless there is an import alert issue to the facility, we do not believe that the contingent payment is at any risk.

Aditya Khemka:

Okay. So unless there is an import alert, you will get the contingent payment on the date with stipulated between you and Mylan, am I right?

Arun Kumar:

Correct?

Aditya Khemka:

Okay. That day falls in this quarter as in the quarter ending September?

Arun Kumar:

Correct.

Aditya Khemka:

Okay. Okay. Thanks for that. And, sir, secondly I see in your quarterly earnings that there is some claim that Mylan has made regarding the transaction which you haven't provided for. This is as per your Deloitte Haskins & Sells audited report and he has, you know, put a matter of emphasis on that. So just wanted to understand this a bit



more what's the claim that Mylan has on Strides which has not been acknowledged as yet?

Arun Kumar: Okay, sir, before I pass it on to Badree, let me just give you a little overview. Beyond \$250 million contingent payment, if you recall, there is also a regulatory escrow for around 100 million dollars. There are claims related to the regulatory escrow which is a total of \$100 million for which we have already provided \$60 million prior to the transaction. So these are claims related to the regulatory escrow and not related to the contingent payment.

Aditya Khemka: Right. So just a bit of clarification on that. So we have provided in our profit and loss, is that what you mean?

Arun Kumar: It's already provided prior to the transaction – Okay, let me try and give you a little more colour.

Aditya Khemka: Sure. Thank you.

Arun Kumar: So there is a \$250 million contingent payment which has got to do with the warning letter. You asked me and the answers are provided. Apart from that, there was a \$100 million that was considered as the cost of remediation. Out of this remediation, we expected or we anticipated the expenditure not to be over \$60 million. So we already provided for \$60 million along with the transaction.

Aditya Khemka: Right. But none of this has come to materialize as of yet and have you paid any of this \$60 million?

Arun Kumar: Yeah. These are claims made on that and obviously we will resolve them, we will discuss it. And only if that claims are greater than the \$100 million, they will have a material impact on the organization. But the \$100 million is already been provided.

Aditya Khemka: Right. So another question on this. This \$100 million is also due to be accrued by you in cash during this quarter only or sometime in this quarter?

Arun Kumar: No, that is much later.

Aditya Khemka: So this is a three-and-a-half later?



- Arun Kumar:** Not three-and-a-half, but it is at least another six to eight months. There's more time for them because that will only end when the resolutions are in place. So the \$250 Million has nothing to do with the resolution. The \$100 million is dependent upon a successful closure of the warning letter.
- Aditya Khemka:** Okay. Okay. Got it, sir. Got it.
- Arun Kumar:** Thank you.
- Aditya Khemka:** Thanks.
- Prakash Agarwal:**
[CIMB] Yeah. Thanks for taking my question. Just wanted to understand on the filing front how much we have filed in, how much is pending as on the last quarter?
- Arun Kumar:** So we do not have any filings this quarter because, you know, we've just restarted our entire focus on the orals business. So we have currently 26 filings of which 13 are pending approvals.
- Prakash Agarwal:** Okay. And any guidance you have given in terms of filing and approvals for this year?
- Arun Kumar:** 15 filings in the financial year.
- Prakash Agarwal:** Okay. And any, you know, thought on the approvals, we've already got three?
- Arun Kumar:** Yeah. We've got four actually. We've got on the previous quarter. So we expect another four to five approvals.
- Prakash Agarwal:** Understood. Okay. And just on your this contingent payment of this \$250 million, I understand the plan is to have a dividend distribution, but we have seen, of late, some, you know, small ticket acquisitions. So, I mean, is there a plan for any larger acquisitions to scale up the business or we largely intend to distribute it as dividends?
- Arun Kumar:** Prakash, like you rightly said, there were small ticket acquisitions which are funded from the cash we already



have the fact that we have no debt, we have enough leverage to do that. But at this stage, we do not have any large ticket acquisitions. If there are large ticket acquisition opportunities that come our way, we will then obviously present it to our shareholders and we will then have to take a call. But at this time as we speak, there aren't any and therefore the intentions are to distribute the cash.

Prakash Agarwal: Okay. And of this \$250 million there is withholding tax and \$200 million is what is the distributable, if at all?

Arun Kumar: No. It's not that because we've always maintained that there's \$100 million spent on biotech, so there's probably a \$50 million reserve for biotech and after that there would be a distribution.

Prakash Agarwal: Sorry. Of that 250, 50 million is for the biotech?

Arun Kumar: And \$50 million maybe tax.

Prakash Agarwal: Okay. Perfect. Great. And if I look at the current cash position, it is Rs.550 crores post this acquisition, the small acquisition.

Arun Kumar: No. Those acquisitions were done during the quarter, so the total cash maybe less by about Rs.100 crores.

Prakash Agarwal: Okay. Fair enough. And looking at the anti-malaria business and you gave some colour on why the business has not, you know, if you could just elaborate a little more that, you know, if the tenders have been already been awarded, how come there's a delay?

Arun Kumar: The tenders have been awarded but the legal contract writing are ongoing. And only after all that will be procurement start because these are long-term contracts supplies.

Prakash Agarwal: These are two-year contract, right?

Arun Kumar: Yeah. That's right. And this, I think, is relevant for everybody because, as far as we know, nobody has got any business as yet.



- Prakash Agarwal:** Okay. And any ballpark market share number we can share or the total \$150 odd million tender?
- Arun Kumar:** So amongst the – Well, yeah, because that will be public very soon, but we think our business would be approximately between 35 and 45 million doses.
- Prakash Agarwal:** 35 to 45 million doses of the total doses *mein*?
- Arun Kumar:** Sorry, about 200 odd million doses. We've got about 20 odd percent of the total volumes.
- Prakash Agarwal:** Wow. Okay. Great. And, I mean, looking at last quarter, I think, you shared the number which was around 23, 24 crores last quarter on the institutional business on the malaria?
- Arun Kumar:** Yeah, on the malaria.
- Prakash Agarwal:** And what is the number this quarter, sir?
- Arun Kumar:** It's zero. No supplies have come.
- Prakash Agarwal:** And the last quarter it was 24 crores?
- Arun Kumar:** That's right.
- Prakash Agarwal:** Okay. Okay. And when this business comes, you would probably see this business?
- Arun Kumar:** Just restrict your questions to one or two and feel free to contact as I guess all come back on queue because I guess there will be others who may want us one question.
- Prakash Agarwal:** Sure, sir. Okay. I will join by the queue. Thanks.
- Steward Lee:**
[Mangrove Partner] Hello. I actually had a question on the institutional malaria business, so the 35 million to 45 million doses that you expect versus last quarter's 24 crores would that signify growth that means that this has remained stable? Can you give a little colour there?



- Arun Kumar:** Sorry? So if I am not mistaken, your question was in the last quarter we did 25 crores and so you were leading to, a question which I was not very clear. Could you please repeat that?
- Steward Lee:** I am sorry. Sure. So based on the awards that you received, you said that the institutional malarial business would be 35 million to 45 million doses, so I guess how many doses were sold at last quarter for that?
- Arun Kumar:** Well, you know, there are multiple strengths. Okay. Looking at a value range, this is between \$25 and \$30 million.
- Steward Lee:** Okay. I got it. Thank you.
- Arun Kumar:** Because there are doses of paediatrics or adults. It's very difficult to tell you the exact number of doses. And whatever we sold in the last quarter is not included in part of this new contract, I mean, it's not part of the contract. That was an old regime which is migrating to a new tendering ecosystem, as they call it.
- Arun Kumar:** Yeah.
- Hitesh Mahida:**
[Antique Stock Broking] Thanks for taking my question. Sir, just wanted to check, so what you are saying is over this \$250 million which we are expected to receive by the end of this quarter, \$50 million we will hold back for biotech business and \$50 million will be tax?
- Arun Kumar:** Yes.
- Hitesh Mahida:** Okay. And the rest \$100 million we might receive after probably six to eight months' time?
- Arun Kumar:** We won't receive it. The other 100 million there are expenses which we have to reimburse. We have already believed that our expenses would be at least 60 million and that is why in all our commentary we expect the total money due from Mylan to be 250 plus 40, 290 million. 40 million may take up to a year for us to get a final resolution



because that will be released only when the FDA warning letter is lifted..

Hitesh Mahida: Okay. And, sir, we had kept around \$100 million in escrow account for tax purpose, so when can we expect that to receive?

Arun Kumar: Four years.

Hitesh Mahida: In four years' time, still four years' time? Okay. And, sir, just wanted your view, I mean, we have shown a good margin expansion despite no major launches in the US and also the anti-malarial business not being there during the quarter. So just wanted to know what's been driving these margins?

Arun Kumar: So, maybe, we have got some very niche products approved in Europe. We have Ursodeol. We are one of the first generics. It's a very small molecule, but it's highly profitable. We have couple of other products that we launched last quarter in Europe, in UK and in other parts. We've got Vancomycin approved now in Canada and in other parts of regulated markets. So all of these are pumping up slowly the margins and obviously as we enter newer markets, this will add to the base EBITDA growing even better.

Hitesh Mahida: Okay. And, sir, when we say Europe, so which are the countries wherein we are doing really where within Europe?

Arun Kumar: The UK market we front-end ourselves and the rest of Europe we partner, I mean, we partner with other large generic companies because we do not have our own salesforce, but in the UK we operate under our own label and it's a growing business, it's a very profitable business given all the regulatory challenges of some other companies operating in Europe. It's a market that's really looking up especially UK now for us since the last two quarters.

Hitesh Mahida: Okay. And, sir, the Strides Actives we have bought back 60%, so what is really this subsidiary.



- Arun Kumar:** I am going to ask Badree to comment on that.
- Badree Komandur:** Yeah. This is a company which should be used for the purpose of the new acquisition which we have for Raricap. There are some small capital which we've bought it back. It's a very thin capital actually.
- Arun Kumar:** Right. It's not material. There was no money paid out for this. They were, you know, when we started, it is a company which we will use to acquire the Bafna ownership of Raricap. I think the payout was less than \$200 million.
- Hitesh Mahida:** Okay. And, sir, the press release indicates that the Malaysia facility might take longer than what we are anticipating. So when can we expect completion of this facility?
- Arun Kumar:** We have given ourselves three months to get a complete clarity. So in the next call we will give you a clarity because we have been very forceful with the Malaysian government that if we don't get all the necessary approvals, then it will be a difficult thing for us to do. So we are working on it.
- Hitesh Mahida:** Okay. And, sir, at the start of the call you mentioned something like 12 crores of interest accrued on investment... Yeah.
- Arun Kumar:** Macquarie would have done this to get this call little discipline. It's a good idea to restrict your number of questions and come back on the call. I do not know why they didn't do it at the opening.
- Hitesh Mahida:** Okay, sir. Okay. No issues. Thank you.
- Aditya:**
[Ambit Capital] Yeah. Hi. Thanks for taking my question, again, sir. Sir, again, coming back to the question on the change in depreciation, it's again as per your audited report, so I understand that we need to have the youthful life of assets as per the companies act, the new act, and we can opt for either SLM or WDV. So when we finally adopt to those standards, what is the likely impact that we will have on our depreciation?



- Badree Komandur:** We have evaluated and we will be adopting in the coming quarters. We don't expect a significant change in the current numbers.
- Aditya:** No significant change from what you are currently charging as depreciation? Okay. And, sir, the next question is on the US business again. So the products that we got approvals for Tacrolimus and Imiquimod, both of the products would be marketing in US under our label?
- Arun Kumar:** Yes. So since 1st of January, all products are being marketed in the US ourselves, except for Vancomycin which is a slightly longer partnership with Alvogen. But every other product is being marketed by Strides.
- Aditya:** Okay. And, sir, lastly what is the R&D expense for the quarter for us?
- Arun Kumar:** So its' about 50 million rupees.
- Aditya:** And what do we have in mind for the full year?
- Arun Kumar:** So it's totally about Rs.70 million including biotech.
- Aditya:** Okay. And what do we target as a full year R&D expenditure for FY15?
- Arun Kumar:** Close to 400 million.
- Aditya:** Okay. So thank you. I have a couple of more questions. I will join back at the queue.
- Arun Kumar:** Thank you.
- Nitin Agarwal:**
[IDFC Securities] Hi. Thanks for taking my question. Arun, on this ANDA filings, are there any specific therapies are we focusing on or how are we looking at the future filing?
- Arun Kumar:** We are not looking at any therapies, Nitin. Our strategy is always to find niche products, soft gelatin as a domain. We have a lot of sachets. We are now increasing our portfolio in creams and ointments. So, yeah, it's diverse. It's the same philosophy of finding products. Most of our products



hopefully would be products like **Methoxsalen** and small sales few generic play and high margin products.

Nitin Agarwal: And you see this number kind of continuing even in the coming years or 10-15 odd filings per year over the next two-three years also?

Arun Kumar: 15 is a low number because we've just reengineered the capabilities in R&D. We will get to a 25 filings per year from the next financial year.

Nitin Agarwal: Okay. And, secondly, on this Raricap deals transaction that we just completed, you know, I mean, how do you see this acquisition in terms of the potential of this, I mean, you especially have mentioned that it's like a game changing acquisition for the domestic business, so how does it really play out for the domestic business?

Arun Kumar: Well, you see, for us we do have a woman and child division, but we didn't have a flagship product and Raricap kind of made up for that. And, more importantly, you will probably recall that our branded business is very nascent and it is focused only in the South of India, whereas, Raricap operates all over India. So now with this acquisition which we close by end of October, we would be operating in all states of India, except for Jammu and Kashmir and Rajasthan. So that kind of makes it an all India player with close to about 700 reps with two key products with Renerve run rate, like I mentioned in my opening, get into upwards of Rs.60 crores this year and Raricap's run rate is in a good Rs.28 to Rs.30 crores. So both of these will kind of give a fill up to our domestic run rate business. I wouldn't say it's a game changer, but it's the beginning of the right steps to becoming an important player in the market focusing on niche therapies and profitable products.

Nitin Agarwal: So you will be looking to do more transactions to add to this portfolio?

Arun Kumar: Yeah. We would like to aggregate more as long as our pricing is correct and it fits our capital allocation in terms of return on investment.



Nitin Agarwal: And if I can squeeze the last one on this, are you also looking at the prospect of taking this product to other markets outside of India?

Arun Kumar: Yeah. So Raricap has had global orientation. Johnson & Johnson used to sell in various markets of the world and we acquired global rights. So, yes, we definitely would take these products. So it is already registered in various markets. So we believe that we can push sales of this product on a global basis.

Nitin Agarwal: Okay. Thanks very much.

Arun Kumar: Welcome.

Saravanan:
[Unifi Capital] Yeah. Good evening, sir. Two questions. One, through any of our group companies, do we have backward integration for our malaria business, in the sense, are we involved in the Artemisinin cultivation?

Arun Kumar: SeQuent, which is not a group company, it's a promoter owned company, it's one of the few Artemisinin cultivators, extractors and manufactures and supplies to various companies and it supplies to other companies outside of Strides which have won the malarial tender. Even before Strides got the approvals, it has been supplying product to other companies. So, yes, we are, but obviously being an associated company. We, Strides, get the first right of refusal on volumes because they didn't have this kind of momentum earlier. SeQuent doesn't have that much capacity, but Strides is getting an allocation to meet their demand. But Strides have access to other vendors too. They are qualifying other vendors. So, yeah, in a way we are integrated to answer your question.

Saravanan: Okay. But I presume pricing will be arms' length?

Arun Kumar: Yes, sir. We have very strong mechanics and the pricing has to be comparable to any other equally qualified vendor for SeQuent to get supply from Strides.

Saravanan: Okay. Great. And my second question and also the last question from my side is who are your competitors in the



soft gelatin space especially in the Indian market, I mean, Indian players?

Arun Kumar:

Well, there are a few. Universal Capsules which has been acquired by Sanofi is a large player. We also are aware that Marksans is a player. But other than that, I am not sure of any other company which is like operates in the regulated markets.

Saravanan:

Okay. So in this space it will be a limited competition whatever opportunities you are pursuing the generic space there will be a limited competition? Is that how we should understand?

Arun Kumar:

Yeah. I don't think there are more than 7 or 8 FDA approved sites globally and they would be at best two in terms of softgels. But there are other companies like Sun Pharma making softgels in the US facility and Dr. Reddy is making a product, but, yeah, I don't think they are very domain-focused. That's my understanding and I could be wrong.

Saravanan:

Okay. Thank you, sir. All the best.

Arun Kumar:

Thank you all for taking a time out and listening to our quarter results and please feel free to contact us for any additional information. We will be more than delighted to provide that. Thank you all.