“Laurus Labs Q1 FY’21 Earning Conference Call”

July 31, 2020

Moderator: Ladies and gentlemen, good day and welcome to Laurus Labs Q1 FY'21 Earning Conference Call hosted by Kotak Securities Limited. As a reminder all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. I would now like to turn the conference over to Mr. Chirag Talati from Kotak Securities Limited. Thank you and over to you, sir.

Chirag Talati: Good morning, everyone. On behalf of Kotak, I thank the Laurus management team for giving us opportunity to host this call today. From Laurus, we have with us today Dr. Satyanarayana Chava – Founder & CEO; Mr. V V Ravikumar – ED & CFO and Mr. Monish Shah from Investor Relations Team. I now hand over the call to Dr. Satya for their opening remarks. Over to you, sir.

Dr. Satyanarayana Chava: Thank you, everyone and a very warm welcome to our results conference call for Q1 Financial Year '21. I wish everyone, with their family members and their colleagues are safe during this COVID pandemic.

The national lockdown started in late March and most of April 2020 which had resulted in very little impact on our operations. We quickly restored operations near normalcy at our plants and other locations by end of April '20. At Laurus, we are committed to protecting the health and wellbeing of our employees and their families. We have enhanced the safety and hygiene requirements across all locations with thermal screening on a daily basis, along with elaborate sanitation protocols, maintaining physical distancing, norms and sanitizing all transport vehicles. With all these efforts, all our units came back to normal levels of production during April '20 itself. I am very thankful to all our colleagues for rising up to this challenge and ensuring business continuity.

Moving on to our Q1 FY21 Revenues, we achieved Rs.974 crores in revenues, showcasing a robust growth of 77% on year-on-year. When you look at our growth pattern, interestingly, Anti Viral APIs, we achieved 19% growth, at Rs.336 crores from Rs.283 crores. Oncology, we grew our business by 13%. Interestingly, other products, we increased our revenue from Rs. 44 crores in Q1 FY'20 to Rs.135 crores in Q1 FY 21. Overall, the generic API recorded a 40% growth, almost Rs. 150 crores growth from Rs.372 crores to Rs.522 crores in Q1 current year. Synthesis business also recorded healthy growth; from Rs. 73 crores in Q1 FY20 to Rs. 100 crores in Q1 FY21. But more importantly, the Generic Formulations division achieved significant growth of Rs.246 crores growth from Rs.106 to Rs.352 crores. In total, Rs.551 crores we did in Q1 FY'20, and we did Rs.974 crores in Q1 FY'21. As we were communicating earlier, we are on track to improve our ARV API sales to previous higher around Rs.1,350 crore this year itself based on the current forecast.

To begin with, I would like to share Key Updates on our Formulations Business. The Formulations division reported Rs.352 crores revenue. The revenue contributions from the FDF segment has improved to 36% of the quarter as against 29% of the whole FY20. The growth driver for the Formulations business remains business remains the partnership with Global Fund, PEPFAR and also from various in-country tender businesses.

During the quarter, we also got approval for two first line products -- TLE400 and TLE600. And we expect to generate revenue in the coming quarters. We continue to have good visibility for our business in FY'21 and beyond.

Apart from the LMIC business, we also have healthy growth in developed markets of North America and Europe. The sales growth in the US primarily because of increased volumes of existing product and the launch of Hydroxychloroquine by our partner in the last week of March. However, with the WHO ending global trials on Hydroxychloroquine and a lot of controversy surrounding the product, we do not foresee any increase in demand in the coming quarters, but we continue to maintain our mid-teen market share in Pregabalin. We have a total of eight final approvals and five tentative approvals, a total of 26 ANDAs filed so far.

In Canada, we have five approvals, out of which we have launched three products and we intend to launch two more products soon.

As far as EU is concerned, I am very happy to share that the contract manufacturing opportunity for certain non ARV Formulations products is performing very well and we have a very robust order book for FY'21 and beyond.

Besides these current products, we are also in the process of launching two new products in various European markets under our own label. So far we obtained approvals for five products, of which we have launched two and we will be launching one more product in the near future.

During the quarter, we acquired Aspen Pharmacare's South African subsidiary called Phekolong Pharmaceuticals, and we renamed it as Laurus Generics SA (PTY). We did this to enable us to enter the South African formulations tender market from the next tender cycle. As you are aware, South African ARV market is the world's largest tender-driven market.

With a robust outlook and order book, we continue to invest in FDF infrastructure. As you are aware, we have undertaken bottlenecking project and a capacity expansion project in the existing building. Both will add to our existing capacities during current year itself. We have also undertaken a Brownfield expansion project on the same site with similar capacities, which will become operational during the next financial year in two phases, partly by September '21 and fully by December '21. With this expansion, our FDF installed capacity will be closer to 9 billion units per year.

On the R&D front, we continue to invest similar levels of expenditure and we aim to file about 8 to 10 ANDAs every year. R&D as a percentage of revenue decreased because of increase in revenue to 4.3% for Q1 FY'21.

And I would like to share the Status of Filings. We have filed 26 ANDAs in US, 9 dossiers in Europe, 11 in Canada, 8 with WHO, 2 dossiers in South Africa for ARVs, 2 dossiers in India for the rare disease drugs. And we also filed 12 products in rest of the world markets to capture the ARV opportunity. Out of the 26 ANDAs filed in US, we believe there are nine Para-IV and out of these, seven first-to-file opportunities having an addressable market size of over $10 billion. From the beginning, our approach remains product-specific, not market-specific. When it comes to the division-specific information, our Anti-Viral business recorded healthy growth of 19% for the quarter. The growth was led by higher volumes and offtake in TDF along with the commencement of third-party sales of Dolutegravir. The second line ARVs have seen good traction in terms of customer registration and we expect a healthy revenue generation from second half of this financial year. I expect this segment to deliver good growth this year on the back of for higher sales of the first line treatment and also the stability in the Efavirenz market and commencement of third-party sale of Lamivudine.

When it comes to oncology APIs, we did Rs.51 crores in the current quarter, and we recorded a 13% growth.

I would like to mention that we have one of the largest high potent API manufacturing facilities in the country and we have seen good traction on the customer front and we expect reasonable growth in this business and confident to increase market share of three of our key products.

The most important part of our API business is diversification of API revenues other than Anti-retroviral. We did very well in that front. In non-ARV, non-Onco APIs category we did a revenue of Rs.135 crores in Q1FY21, with a growth of almost 200% when compared to the previous year. The growth in this segment was driven by new contract manufacturing products along with higher volumes of existing products. We also have a certain amount of dedicated capacities for select opportunities which will enable us to grow this business further in the next financial year. This business is growing with global partners, and we are in a sweet spot to capture opportunities under the current global supply chain disruptions. On the back of sizeable order book, new product introductions and expanded capacities available, we are very optimistic about the growth prospects of generic API contract manufacturing as well.

The other business on which we are very bullish is our CDMO business. We did a sale of Rs.100 crores for the quarter with a growth of over 37% year-on-year. Currently, we have close to 50 active projects and we had the highest number of customer additions in the last two quarters with programs in various clinical stages.

We have incorporated a wholly-owned subsidiary, Laurus Synthesis Private Limited in May '20. This was done in order to give the business an increased focus and eventually a dedicated R&D and manufacturing sites in the near future.

I would like to inform you that the new subsidiary, Laurus Synthesis Private Limited acquired assets of a pharma unit in Vizag for a consideration of Rs.61 crores in the last quarter. This unit will be used for early clinical phase chemistries for the Synthesis division.

With that I would like to handle to Ravi to share Financial Highlights.

V V Ravikumar: Thank you, Dr. Satya and a very warm welcome to everyone for our Q1 FY'21 Earnings Call, I wish all of you and your family members to be safe and healthy in this toughest time in the history of our times.

The total income from operations for the quarter is at Rs.974 crores against Rs.554 crores with the 77% growth. With better product mix, we have seen an improvement of gross margin by 4%. This includes the part of the FOREX gain to that extent of a couple of percentage points. Our EBITDA margin came at 29% and this is mainly because of the operating leverage and the change in product mix. And our ROCE improved to 32%. This is because of the higher profitability. Our diluted EPS is 16.1 on an annualized basis with a growth of 1,050%. On the CAPEX front, we invested about Rs.91 crores. Apart from that, we also invested Rs.61 crores asset through our wholly-owned subsidiary, Laurus Synthesis Private limited. And we have many opportunities to invest in FDF and API infrastructure. We will be incurring CAPEX close to Rs.300 crores in this year. All the CAPEX opportunities are Brownfield at this juncture and will have a short payback period. We expect our CAPEX program to be ROCE-accretive. We are also looking for an alternative site for the formulations but that will take more time.

With this, I would request the moderator to open the lines for the Q&A. Thank you.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question-answer session. The first question is from the line of Karan Rathod from AUM Advisors. Please go ahead.

Karan Rathod: We have been hearing a lot of reports with respect to US pulling out of WHO funding especially for stuff like aids and malaria, etc., So if you can just comment on what your view is on the sustainability of your FDF sales in LMIC countries?

Dr. Satyanarayana Chava: The major funding for HIV, TB malaria programs comes from two organizations -- One is Global Fund and other one is PEPFAR, that is President's Emergency Plan for AIDS Relief. Global Fund operates in 150 countries with a three-year funding cycle and the current cycle is for 2023. The current funding cycle pledges $13 billion, out of which $4 billion allocated for FY'20 for fighting HIV, TB, malaria. What is also very important is Global Fund allocated a

billion dollar to mitigate the impact of COVID-19 on treatment of HIV, TB and malaria patients. What it shows is they were increasingly funding during this pandemic …they have not reduced the funding. The same thing happened with the PEPFAR. They operate in 50-countries as against 150-countries with Global Fund. From the inception, PEPFAR has spent $85 billion on AIDS funding itself and 45% is spent on care and treatment. Even under this crisis, $500 million additional flexibility was given by PEPFAR to the countries who are using those funds. The US pulling out of WHO has minimal bearing on the funding mechanism. It will have a bearing on how WHO operates in the principles and policies, but WHO does not fund any of these programs. At least half of the HIV funding is from in-country resources. So there is a little or no impact on HIV funding because of this pandemic or because of US pulling out of WHO.

Karan Rathod: My second question is that your API sales, others have increased by more than 200%. If you can throw some light, is there any sort of one-off or something which cannot be repeated over the next few quarters, is there anything of that sort within the sales or you think that this sort of growth rate can be achieved of a base that you have established in Q1?

Dr. Satyanarayana Chava: The only one new product we have launched in Q4 FY'20 and Q1 FY'21 is Hydroxychloroquine. That generated less than 5% of revenue and less than 5% of gross margin. So, there is no one-off revenue or one-off gross margin or profitability in the Q1.

Karan Rathod: My last question is if you can just talk about a little bit about the guidance in terms of CAPEX for FY'21 and FY'22. And with that capacity, what will be peak sales achievable at full utilization for Laurus as a whole?

Dr. Satyanarayana Chava: I can talk about how much CAPEX we are investing and we have to wait and see how much revenue it generates. We are increasing our API capacity by close to 20% in the next 12-months and we are increasing our formulations capacity by 80% in the next 18-months. So, we initiated our CAPEX program already as Ravi mentioned. Earlier, our CAPEX is for future requirements. Now, with the current CAPEX, we know what products we will make and how much we will make. So the CAPEX also we are doing in a Brownfield way rather than creating Greenfield sites.

Moderator: Thank you. The next question is from the line of Nikhil Mathur from Ambit Capital. Please go ahead.

Nikhil Mathur: My first question is that how much time does it take for you to get visibility on order book and then fulfill the order? The reason I am asking this question is that in this particular quarter, be it other APIs, be it ARV APIs, formulations, Synthesis, the growth on quarter-on-quarter basis is phenomenally high versus what it was in 4Q or 3Q. So, what I am trying to understand is why were the guidance a bit soft during the 4Q results? Surely, this order book would have been a bit visible right.

Dr. Satyanarayana Chava: You are right. Maybe you can blame us as we are a conservative guys giving forecast… but when you are asking, we are not giving how much we will grow also. So today, as everybody feels, we also have the vision to grow and we have the ability to grow, we have products, we have facilities, we have all relevant regulatory inspections done. We wish we will also grow as much as we can. We can only comment at that stage, but we are not giving any absolute number guidance for our revenue or profitability from the beginning.

Nikhil Mathur: Across the segment, do you have to order book visibility over the next two, three quarters that whatever sales pace has been achieved in different segments, that can be replicated in the subsequent quarters, I can understand there can be quarter-on-quarter variations depending on certain order based on timing mismatch. But are you sounding confident that this particular sales pace in all the segments can be replicated over the next two, three quarters?

Dr. Satyanarayana Chava: You have to compare our Q1 FY'20, Q1 FY'21, there is a quantum jump. But when you look at our Q2FY20 number, we did more than Rs.700 crores. So we will see certainly good growth. We can assure you that we have the abilities to maintain to sustain the growth what we have demonstrated in Q1FY21. I may not be able to give you the exact number, but we have the ability to sustain the EBITDA numbers and our PAT numbers percentage wise.

Nikhil Mathur: Another question I have is on the gross margin. Now, I think this is very helpful, quantification of FX benefit of a couple of percentage points. But if I still compare to quarter-on-quarter, I think ex of FX also the gross margin has improved by almost 2.5% points. And this is despite Synthesis contribution being lower which is the usual seasonality in your business. So, can you help us understand that what has changed here that even with Synthesis contribution being lower, the gross margin is still better on a quarter-on-quarter basis or there were some FX loss in 4Q?

Dr. Satyanarayana Chava: The gross margin improvement, as Ravi mentioned, partly helped by FOREX gain by close to two percentage points. Another significant reason for gross margin improvement is primarily change in product mix and improving efficiencies in our process and also purchase efficiencies. And we can also tell you the gross margin improvement is not because we increased our API prices. It is because of our internal efficiency improvement, we are able to improve our gross margins.

Nikhil Mathur: Employee cost has increased substantially from Rs.88 crores in FY'20 to Rs.111 crores in this particular quarter. So, is this a new base or there were some front-ending of expenses and hence in the subsequent quarters, the employee cost might be a bit lower?

Dr. Satyanarayana Chava: We have incurred close to Rs.15 to 16 crores of employee cost as incentives during the COVID pandemic in the Q1FY21. Incentives mean you have to provide an additional transportation cost to our colleagues. So those were closer to the tune of Rs.15 crores in the Q1FY21 and we do not

know how Q2FY21 will behave because still we are not out of the COVID pandemic across the country and world. It all depends on how the COVID situation will vary from Q1 to Q2FY21.

Nikhil Mathur: And just one final question linked to employee cost. Usual variable payout for your employees in which particular quarter is that paid out?

Dr. Satyanarayana Chava: Already paid out.

Moderator: Thank you. The next question is from the line of Suji Nahar from Nahar Investment. Please go ahead.

Suji Nahar: My first question is can you provide details around volume growth versus value growth for the different segments like ARV, API, Oncology and other API and Custom Synthesis?

V V Ravikumar: We are not quantifying volume growth versus value growth. As Dr Satya said, there is no price increase. So, you need to take the whole thing is as volume growth.

Suji Nahar: Second question is like company has started commercial scale production for four products in Custom Synthesis. So, if you can share more details around the revenue visibility or opportunity side for this product?

Dr. Satyanarayana Chava: We are not giving the details of revenue per product wise which is against our principle in giving that sensitive information how much we are selling APIs commercially. But we can assure you we foresee volume growth in our commercial products during the current financial year itself.

Moderator: Thank you. We take the next question from the line of Prashant Nair from Citi Group. Please go ahead.

Prashant Nair: I just had a couple of questions. So firstly, on the other API sales line, so how do we see this particular category growing from here, is this quarter run date representative of what the ongoing business could be? And secondly, on the broader API business itself, is there any element of stocking up by your customers given that we are still grappling with the pandemic and different lockdowns or is this business as usual kind of?

Dr. Satyanarayana Chava: Contract Manufacturing of generic API is a growing segment for the company. You have to look this contract manufacturing year-to-year rather than quarter-to-quarter, because of production schedules at our end and at customer end, we do make campaigns of contract manufacturing products. And if you take the year-on-year, we are very confident to grow the segment. You cannot multiply our Rs.130 crores into four. Can you do Rs.500 crores of contract manufacturing? There will be significant growth year-on-year but we cannot guarantee you. You cannot do the simple arithmetic 130x4.

V V Ravikumar: But Prashant, there is no stocking up by the customers.

Prashant Nair: Your cost of debt seems to have come down. So, can you just give us a sense of what is the current cost of debt and how do you see this over the next year or two years?

V V Ravikumar: The current cost of debt is less than 7%, inclusive of everything. But we expect to be improved from now onwards.

Moderator: Thank you. We take the next question from the line of Nitin Agarwal from IDFC Securities. Please go ahead.

Nitin Agarwal: Two things: One is on the formulations business, does the impact of Hydroxychloroquine reflected in FDF for other API?

Dr. Satyanarayana Chava: As I mentioned earlier, Nitin, the contribution of Hydroxychloroquine in both API and formulations business put together is less than 5% of our sales and less than 5% of gross margin. So, our future quarters' revenue is not dependent on any opportunistic sales related to COVID or any other one-time.

Nitin Agarwal: Secondly, on your finished formulations capacity, last quarter you had indicated that you were almost running at peak capacities and we have had a meaningful delta on that number in Q1. So there has been some volume increase in the formulations businesses this quarter, there has just been value increase which have come through in this quarter for FDA business?

Dr. Satyanarayana Chava: The higher revenues have come because of volume growth. We have done some operational efficiency programs internally and we are also debottlenecking in two phases -- the first debottlenecking will come handy in September and new line addition within the existing, will come by December. And we are also building a very large capacity in the same site mostly for non-ARV products. So, we are having constant capacity enhancements within the existing building as well as putting up a new building.

Nitin Agarwal: On the gross margin improvement as you alluded to in the past, QoQ if we look at it, you said two percentage improvement essentially is on FOREX. On the mix sir, the bulk of the improvement, is it on any particular segments where the improvement in gross margin has come from on the API side or what has it really driven it because it has been a fairly sharpish improvement even adjusted for the FOREX gain sir?

Dr. Satyanarayana Chava: Majority of that gross margin improvement came from API business, you are right.

Moderator: Thank you. We take the next question from the line of Tushar Manudhane from Motilal Oswal. Please go ahead.

Tushar Manudhane: Just would like to understand on the other API segment, what would be the product concentration, maybe like top three, top five products contributing how much of the revenue?

Dr. Satyanarayana Chava: In other API segment, it consists of non-ARV, non-onco where we own the DMFs and we also do contract manufacturing with generic APIs for our customers. There is no product concentration in other APIs. It is very well spread.

Tushar Manudhane: And on the ARV API side, Lamivudine on the external sales side?

Dr. Satyanarayana Chava: You are right, the increase in ARV API sale primarily came from increased volumes of Tenofovir and third-party sale for Lamivudine and Dolutegravir. Why I am saying third-party sale of Lamivudine and Dolutegravir, these are new approvals to our customers, whereas Tenofovir most of the customers were approved much earlier. So the sale improvement came from three APIs – Tenofovir, Dolutegravir and Lamivudine.

Tushar Manudhane: On this DTG side conceptually it was like this is relatively low volume product compared to say Efavirenz. But despite that, if you can just highlight what kind of market share we have now on DTG API side through sale to the formulations?

Dr. Satyanarayana Chava: Actually, we are trying to improve our market share for Dolutegravir. We started commercial sale only in Q4 FY'20. So, we expect to increase our market share as the Dolutegravir increases market share in the first line treatment. And when it comes to Efavirenz, what is also interesting is that, Efavirenz demand came down globally by 60%, but our revenue drop in Efavirenz is not 60%. That means we were gaining market share of Efavirenz even though volumes are going down. So, we can say the Efavirenz sales have stabilized. That was the reason where we had lower sales in the previous quarters. Now, we are back on track to achieve growth led by Tenofovir, Dolutegravir and Lamivudine. And next year also we expect to grow in ARV APIs primarily because of second line APIs which we start selling from second half of this financial year.

Tushar Manudhane: Just on this formulations side, while we have eight ANDA approval, but we have commercialized maybe one. So any particular reason for postponing the commercialization of the ANDA, is it to do with the economic viability or the capacity constraint or some other products becoming more interesting?

Dr. Satyanarayana Chava: We have a very different plan when we are going to be launching. We are also getting in-country approvals. So you get approval from FDA, is not the only criteria, you have to get the local country approvals also. We are in the process of getting those approvals and we will launch TLE400 in Q2FY21 itself.

Moderator: Thank you. We take the next question from the line of Amey Chalke from Haitong Securities. Please go ahead.

Ameya Chalke: I have two questions: First, is related to DLT. Sir, if you can explain the DLT landscape at present in the tender market as in how much switch has happened from you, all the products will be the newer therapy?

Dr. Satyanarayana Chava: In the first line DLT treatment occupies maybe 70% of the market share, remaining 30% is done through TLE or TEE, and we expect that ratio will continue in the future as well. And the first line ARV treatment value broadly will be $1.5 billion. So you can say DLT sales could reach a billion dollar for all companies put together.

Ameya Chalke: And do you expect any new entrants coming in the DLT market because I believe there are four players currently?

Dr. Satyanarayana Chava: There are eight approvals right now in DLT. Actually, five are commercially selling. And I think there is a market for everyone. We are not worried about new players coming in. It all depends on the ability to meet demand when market exist. We believe we are well prepared to take the opportunity.

Ameya Chalke: Now, considering this large part of the market has already been shifted to DLT, do you think there is still good opportunity left in case of other approvals?

Dr. Satyanarayana Chava: We strongly believe there is an opportunity in TLE400. There are only two approvals and we are the third. So, the market shifted from TLE600 to TLE400. And we believe TLE400 will be used primarily for woman HIV patients, because of significant weight gain observed on Dolutegravir treatment. So 25%, 30% market share will be Efavirenz-based and the remaining will be Dolutegravir-based.

Ameya Chalke: To get some comments on the recent government's PLI Scheme, how do you view it for the Indian API industry and also, are we looking forward to participate in the scheme?

Dr. Satyanarayana Chava: The PLI Scheme announced by the government is a good step towards self-sufficiency in certain API. And we are evaluating opportunity and we will participate in a few of the APIs where a product already we have developed and we have capacities and we are looking into it.

Moderator: Thank you. We take the next question from the line of Kaustav Bubna from Rare Enterprises. Please go ahead.

Kaustav Bubna: Could I please request you to give me the breakup of your generic FDF business of Rs.352 crores of revenue which you did, rest of the world tender, North America and Europe in percentage terms?

Dr. Satyanarayana Chava: This is three-fourth LMIC and one-fourth in advanced market. I think the revenue broadly falls into that ratio.

Moderator: Thank you. Next question is from the line of Madhu Kela from MK Ventures. Please go ahead.

Madhu Kela: My question is little medium-term. With the kind of cash flow which the company is generating, when do you think we will become free cash flow-positive given your robust CAPEX plan as well?

V V Ravikumar: Even in Q1FY21, we have positive free cash flow by the amount is small. Because the endeavor is to gear up for future revenue growth. So, this year itself we will have a positive free cash flow.

Madhu Kela: But, Ravi, do you think that debt will come down substantially over the next two, three years?

V V Ravikumar: It all depends on the opportunities. If we have a better opportunity for investment into further CAPEX and business, we will not consider in debt reduction, we will use for the CAPEX expansions. If we do not find that reason, then we will repay. See, if you look at our debt, the overall debt cost is around 6.6% and it will further come down, it is not a very significant. Even if you take a tax rate, the effective debt cost will be very small.

Madhu Kela: Ravi, what is the risk which you see if at all any over the next two, three years for the company?

V V Ravikumar: Madhu ji, the risk will be the regular risk of any of the pharma business, the regulatory and safety. Other than that we do not find any major risk anticipating.

Dr. Satyanarayana Chava: I will add one point here. There is no capacity risk. We have annual capacities. There is no product risk. There is no regulatory risk we believe. There is no customer risk. And in the therapies where we are right now, all chronic and we do not see any seasonal variance in the offtake as well. So looks like we are in a good platform right now to maintain this growth and provide sustainability to all of you.

Moderator: Thank you. We take the next question from the line of Sajal Kapoor from Unseen Risk Advisors. Please go ahead.

Sajal Kapoor: Just a couple of questions: First upon our CDMO business, today, we have a total of 47 active projects and a new commercial supply which is paid. But can you also share the number of customers we serve today and how that number has changed over the years? On the presentation slide deck, you mentioned that several late stage projects have been executed. So, would you mind sharing how many molecules do we have in phase-3?

Dr. Satyanarayana Chava: Currently we are working with four out of top-10 big pharma and several small medium and virtual biotech companies. We had success in all categories, big pharma, medium, and virtual

companies. As we mentioned, in several in the late stage, we cannot quantify right now, because that is the challenge with these NCE molecules, we do not know which molecule move into the next phase and how much market they get. But we have added a significant number of customers in the last two quarters. Interestingly, a couple of customers opportunities are very large opportunities. We can only say this. Beyond this, it is not appropriate for us to give details on the customer projects.

Sajal Kapoor: And second question is Dr. Satya on this reported shortage of the HIV medicines in about 70-countries, so what is your take on this statement? It came from WHO, so it is credible. And also we now have the market accessibility. So do we have the requisite capacity because this shortage should mean that there should be a surge in the requirement and the restocking has to take place because it is essential medicines, what is your sense of this acute shortage in the HIV medications that several countries are now reporting?

Dr. Satyanarayana Chava: There are two aspects here. Most of the countries are going to multi-month dispensing. Earlier, they used to dispense monthly medicines. Now, they move to three months. Eventually they want to move to six months back, that means they get 180-tablets when they go and see a clinician. So that is one. And second, the supply disruption happened especially with one drug called Lopinavir Ritonavir where there is a lot of hype because it is used in the COVID treatment, a lot of stocking happened in that drug. That was in the shortage in many countries in the second line. There were alternatives for second line. So I do not think the same kind of scarcity exists today because many studies proved Lopinavir Ritonavir is not very effective in reducing treatment time for COVID. So that hype is over. So we do not expect any shortage of HIV medicines right now.

Sajal Kapoor: Last question on Pregabalin. Pfizer recently reported a significant drop in the revenue of LYRICA which is their brand, is down 70%, which means that we should be gaining more market share in the near future. What is your take on this one?

Dr. Satyanarayana Chava: I think we are maintaining our market share. Pfizer is losing revenue because they lost market share to other generic companies. We have not seen any increase in our share, but we are glad that we are maintaining our share right now on Pregabalin.

Moderator: Thank you. We take the next question from the line of Cyndrella Carvalho from Centrum. Please go ahead.

Cyndrella Carvalho: Just want to understand your thoughts. You mentioned that on the second line ARV treatment, we expect to see more growth. Could you help us understand highlighting any market share that we intend to garner there and when we will be able to achieve that level over coming to you?

Dr. Satyanarayana Chava: In the second line, we filed DMFs last year and our customers have taken material for exhibit batches and we expect approvals to come in the second half of this financial year and significant revenue will come in the next financial year. With the development of several second line APIs, now we have a full basket of APIs covering both first line and second line, including some pediatric products.

Cyndrella Carvalho: Any comment on the Lamivudine, where do we expect it to reach?

Dr. Satyanarayana Chava: Lamivudine primarily is used in first line. The second line API is our Abacavir, Atazanavir, Lopinavir, Ritonavir, Darunavir. Now we have the APIs, DMF filed, and reviewed by global regulatory authorities and our customers will get approval soon. So Lamivudine is not widely used in the second line, it is used primarily in the first line.

Cyndrella Carvalho: Any thoughts on the recent volume growth that you alluded to in the other API segment? What are the key long-term drivers in terms of any strategic change that we are seeing here because of the reduction on the supply chain or the China episode? And are we receiving more enquiries to add some new products to our kitty with our clients, what is the sense on these?

Dr. Satyanarayana Chava: We have not seen any growth coming out of the current supply chain disruptions. But we expect more opportunities to come in the near-term and we are planning to create capacities to take those opportunities. As we mentioned, the change of an API source will take anywhere between 18 to 24-months. If supply disruption happened last month and somebody is getting an opportunity, I do not believe so. So we have some enquiries for contract manufacturing or opportunities for non-ARV APIs, which we expect will materialize in the next two years and we see a lot of opportunities.

Moderator: Thank you We take the next question from the line of Surajit Pal from Prabhudas Lilladher. Please go ahead.

Surajit Pal: Given the kind of scenario in the global front, where we are seeing a lot of diversion of funds going crazily for COVID-19 R&D expenditure as well as procurement going forward when vaccine will come or Remdesivir will come more. Do you think in short to medium term, there could be shortage as far as HIV drugs and in long term, there could be possibility that out of the total pie allocated for HIV, malaria and TB, will also have to give a space to this contagious disease because that could be very dangerous for the HIV patients and that could be going for a lower price for DLT?

Dr. Satyanarayana Chava: The amount of money spent on HIV drugs is $2 billion out of close to $20 billion spent on the HIV pandemic. And in the $2 billion, if you take countries like South Africa, Nigeria, India, China, Thailand, Brazil, Mexico, they have 40% of HIV infected patients in those countries. And these countries' economies are good enough to fund on their own even there is a challenge. So

if at all there is a challenge, they stop giving drugs to the existing HIV patients or will they stop enrolling new patients. We believe the money for treating HIV patients is not a challenge, because so much of advancement is done in controlling and eradicating this epidemic and this will be continued.

Surajit Pal: My point is that it will definitely continue, definitely they cannot let go the HIV patients, but the point is that either they can force the companies to reduce the DLT price forcibly because they also have to fund the contagious disease which is currently going on and that might be something like say they might be going for TLE if companies are not reducing price of DLT or they might be reducing DLT where the commercial prospect or the attractiveness might be lower than what it is currently?

Dr. Satyanarayana Chava: We have not seen such kind of pressure coming so far. But there is a possibility, but we have not experienced that. Here just to give you how the procurement mechanism was. The procurement happens for Q1 calendar year '21 right now. So people buy for future supplies. Nobody buys for August supplies in July. So we have not seen any pressure on pricing so far

Surajit Pal: Could you please elaborate in terms of FOREX gain this time?

V V Ravikumar: FOREX gain is because the rupee depreciation, INR depreciated by almost Rs.5 when compared to an average of last quarter and this quarter.

Surajit Pal: What is this quantum in your numbers this time?

V V Ravikumar: We were saying around 2% gross margin increase, that is around Rs. 15 to 20 crores.

Surajit Pal: Any further explanation for your huge jump in EBITDA?

V V Ravikumar: The improvement in EBITDA is because of the volume increase. We got an operating leverage.

Surajit Pal: So that is the main reason for such a jump in margin in EBITDA level?

V V Ravikumar: Correct.

Moderator: Thank you. We take the next question from the line of Ranveer Singh from Sunidhi Securities. Please go ahead.

Ranveer Singh: A few questions. Like on Europe, our contract manufacturing for that formulations business, I wanted to understand a little bit in detail. Though this is a small business right now, but if you could give some more light of what therapeutic category we are catering to in that CRAMS? And how many customers currently we have for this business? So overall, where we see in next two or three years this business going to?

Dr. Satyanarayana Chava: In the FDF Contract Manufacturing, right now we have one customer. We are doing up to 1 billion units in bulk for that customer per year right now. And we have a few more products addition in the next year. So we expect the 1 billion tablets contract manufacturing in the next 18-months will go to 2 billion, for which we are already creating capacities.

Ranveer Singh: Secondly, what we purchase the unit from Aspen, what is the cost of that acquisition?

Dr. Satyanarayana Chava: We only acquired a company. We purchased the shares of that company with ZAR70,000.

Ranveer Singh: What is the current debt right now?

V V Ravikumar: Around Rs.1,100 crores, the same level of debt we are maintaining for several quarters.

Ranveer Singh: And we are not expecting it to go down. You said you will focus more on CAPEX, right?

V V Ravikumar: Yeah.

Ranveer Singh: What is the CAPEX you guided for FY'21?

V V Ravikumar: Around Rs.300 crores, that is what we said.

Ranveer Singh: So, already Rs.150 crores we have done in this quarter, Rs. 91 crores plus Rs. 61 crores.

V V Ravikumar: When we say CAPEX that is out of Rs. 91 crores, so Rs. 61 crores is an additional.

Ranveer Singh: On the DLT front, how is the demand linear every quarter? We see the demand is coming in a similar way or the order currently we have. So, what percentage we have already catered and what opportunity remains, or it is difficult to quantify, so what are you seeing here?

Dr. Satyanarayana Chava: It is difficult to quantify, but we are running at optimum capacity on the product. We are also increasing capacities for the further products.

Moderator: Thank you. We take the next question from the line of Gagan Thareja from Kotak Alternative Asset Management. Please go ahead.

Gagan Thareja: First question is around the gross margins. A lot of API companies seem to have an expansion in gross margins in the last two quarters. I presume key starting ingredient prices have come down. Would you also have experienced a drop in key starting ingredient prices and if so, what would have been the contribution of that in your gross margin expansion?

Dr. Satyanarayana Chava: We cannot quantify but there is a softening of some raw materials. See, overall, I would say the gross margin improvement primarily is attributed to the product mix, process efficiency, raw

material purchase efficiency and as Mr. Ravi mentioned it is also because of price gain because of FOREX gain.

Gagan Thareja: So, the impact of dropping KSI is negligible?

Dr. Satyanarayana Chava: Very negligible.

Gagan Thareja: The FX gain that you had in your gross margins, eventually do you feel that might have to be passed on or you feel that the gross margins as they stand in 1Q are fairly sustainable for you going ahead?

V V Ravikumar: We are not passing on. Probably it will be sustained if the exchange rate is at Rs.75 or the similar level. If rupee appreciates, so this will come down.

Gagan Thareja: Second question around your formulations sales. Could you give the growth for the LMIC formulations and the regulated market formulations separately?

Dr. Satyanarayana Chava: We are not giving that classification, but broadly as I mentioned in the previous questions, we are doing three-fourth of our formulations revenues in LMIC ARV markets and one-fourth in the advanced markets of North America and Europe.

Gagan Thareja: And the LMIC formulations sales would entirely be coming from the Dolutegravir combination as of now?

Dr. Satyanarayana Chava: No, it is Dolutegravir and other formulations as well, but majority is Dolutegravir-based.

Gagan Thareja: How much is coming from the TLE combinations out of the total ballpark any idea?

Dr. Satyanarayana Chava: TLE400 and TLE600 we are going to launch only in this quarter. So revenue will only come in Q2FY21. We have not generated any revenue in Q1FY21 from TLE.

Gagan Thareja: And given that you are running at full capacity and clearly presents a very good opportunity for you in the TLE400 bracket, would your debottlenecking be able to address your need of capacity to service the TLE400 market?

Dr. Satyanarayana Chava: Yes.

Gagan Thareja: Since this is a three-player market, you see the possibility of significantly higher market shares there vis-à-vis the Dolutegravir market?

Dr. Satyanarayana Chava: Dolutegravir market is much bigger than TLE market. So even we may get higher market share in TLE, but the quantum of revenue coming from Dolutegravir-based formulations will be much higher than the Efavirenz-based formulations.

Gagan Thareja: Could you give us some idea at optimal LMIC formulations sales, what could the combination be between Dolutegravir and the TLE combinations -- would it be 70:30, would it be 80:20, any ballpark number?

Dr. Satyanarayana Chava: No, we are not giving that kind of minute details right now.

Gagan Thareja: And the formulations capacity you are expanding by 80% if I got it correctly. Is that going to be used entirely for the LMIC market or is it also to address the other opportunities and by what timeframe do you feel you will be able to optimally utilize that?

Dr. Satyanarayana Chava: Our new Brownfield capacity is coming in two phases partly by September 2021 and fully by December 2021. And we expect about 4 billion tablets capacity. That additional capacity which will come next year will be primarily used for non-ARVs, nothing will be used for the ARVs there.

Gagan Thareja: And in South Africa you always maintain, that is a bigger TLE market vis-à-vis Dolutegravir combination and now that you are prepared for the new tender cycle there, can you give us an idea of what is the ratio for Dolutegravir to TLE combinations in South Africa. And when does the new tender cycle happen?

Dr. Satyanarayana Chava: New tender cycle will start from 2022. Right now it is evenly divided between Efavirenz, Dolutegravir treatments in South Africa and by the time next tender cycle starts, we expect it will be 75:25 in favor of Dolutegravir.

Gagan Thareja: And within Tenofovir, there was also some talk of shift from TDF to TAF which is the Alafenamide formulation of Tenofovir. Do you see that happening in 2021?

Dr. Satyanarayana Chava: We do not expect that switch will happen.

Moderator: Thank you. We take the next question from the line of Kunal Mehta from Vallum. Capital. Please go ahead.

Kunal Mehta: For the benefit of all the participants on this call, can you please explain the whole cycle of procurement for Global Fund, I mean, you mentioned it is a three year cycle and after three years you would have different set of contracts which will be renewed based on the interest will be considered at that time, so, could you please let us know how does the contract work on a three year basis and how is the business allocated per year, and then once the site contract ends, how does the annual process will work?

Dr. Satyanarayana Chava: The Global Fund contracts work based on they will allocate a certain percentage of their purchases during this period. They may not give you the exact number. Companies will get certain percentage of their purchases. So that is the contract they sign. And typically they honor the contract. And prices will be negotiated for every set of orders, I will not say every order. They only commit percentage of their purchases. And they generally buy more than that, they do not commit 100% of what they will buy. So they commit maybe between 60% to 80% of their purchases to the established players and keep certain percentage for the new entrant. And that mechanism is working very well for the previous cycles also.

Kunal Mehta: Just a follow up on this one. So you mentioned that you have strong visibility till the end of this financial year. And the additional capacity which you are planning to add, it is mainly in non-anti-retroviral. So I just wanted you to understand so what visibility do we have for the LMIC in FY'22, would you throw some light on this?

Dr. Satyanarayana Chava: If you look at our API journey, and we also mentioned in our Investor Presentation, how the diversification happen from 80% of our revenue coming from ARV, APIs in 2016 to 33% of revenue coming from our ARV APIs in Q1 FY'21. So a lot of diversification happened. And we expect the similar diversification will happen in formulations business where majority revenues are coming from ARV right now. So the diversification will take its own time and we started taking steps towards that by building capacity, mostly for non-ARV products. And coming back to your question, Will the company have enough capacity to take more opportunity to ARV? Answer is Yes!

Kunal Mehta: So just wanted to understand this better, you have seen that once we reach a certain level in ARV supposed to reach Rs.1,300 crores by the end of this year, so the next leg of growth will come from non-ARV products rather than ARV on the LMIC side. Is that understanding correct?

Dr. Satyanarayana Chava: We have a lot of scope to grow in ARV also. But we have enough capacities for ARV growth. We know how many products we have filed in non-ARV and when we are getting approvals. Based on the timeline, we are increasing the capacity of non-ARV.

Moderator: Thank you. The next question is from the line of Sangeeta Purushottam from Cogito Advisors. Please go ahead.

Andrey Purushottam: I am Andrey Purushottam, Sangeeta's partner here. We are relatively new to your stock. I just want to understand the FDF business which has exploded in the last two years. Can you explain to us what are the drivers of the success and how do you see these drivers sustaining in the next let us say a year or two?

Dr. Satyanarayana Chava: In the formulations business, our growth primarily came from ARV, LMIC market and growth from Europe came from contract manufacturing, and in US from our own products. We expect

all these three will grow ARV, LMIC as well as the European business because we are also launching new products in Europe on our own label and also contract manufacturing expansion to other customers. We are launching in Canada two new product this financial year and in US, we expect to launch at least four products in this financial year. So, our growth trajectory is very healthy in all these markets.

Sangeeta Purushottam: Sir, this is Sangeeta Purushottam. I had a question on your numbers. You mentioned that there has been an exceptional 200 basis points benefit that you got because of exchange this quarter. So that would account for roughly say Rs.18 crores to Rs.20 crores, at the same time you also had some extra expenses which you incurred because of incentives and COVID, right, which I think you mentioned the number was again in the mid-teens like Rs.14, 15 crores. Would that be right?

V V Ravikumar: Yes, you are right.

Sangeeta Purushottam: So broadly, the benefit in some sense have got netted off by the extra expenses that you have in, and you have some 5% of your businesses which is in the form of one-off. Now, if we sort of net out all these impacts from your total performance, then we are really looking at maybe a PAT of somewhere in the region of Rs.155 crores to Rs.160 crores. My question is, is there a seasonality to your business or when we are looking at the company and trying to project for this year, for the remaining quarter can we expect a similar performance or there some seasons which would be impacting the performance of the company?

Dr. Satyanarayana Chava: There is no seasonality in our product portfolio. And as you mentioned, the Hydroxychloroquine contributed less than 5% and less than 5% of our sales and gross margins in Q1FY21. But that does not mean we are not selling anything in Q2FY21. So we continue to sell Hydroxychloroquine in Q2, Q3 also, but we expect the revenue will remain in the same level. So there is no one-off. You can net it off in Q2 except you calculated very well the COVID-related expenses and FOREX gain. But other than that, there is nothing to subtract our Q1 numbers for Q2.

Sangeeta Purushottam: And sir COVID-related expenses I am assuming would continue for a few more months, right, because the situation has not really changed too much, or would that be not a right assumption?

Dr. Satyanarayana Chava: Probably will continue, but to a lesser extent. In the Q1FY21, we also incurred almost a million dollar on the extra freight. But that will not be there in Q2FY21 for sure.

Moderator: Thank you. We take the last question from the line of Aakash Manghani from BOI AXA. Please go ahead.

Aakash Manghani: Could you help me understand the strategy behind the Synthesis business as of last financial year close to Rs.400 crores in revenue, could you talk about the next three to five years how do you expect this business to shape up given that a lot of the products are going into commercialization**,** the opportunity size is fairly large, probably the largest across all your business segments, so what is the thought process behind this segment, how would you like to shape up there?

Dr. Satyanarayana Chava: Synthesis business, the gestation is very, very long. But it is also very interesting business because there is no development risk, because customer will give you the product, basic process and you optimize and start giving. And there is no price pressure. Volume will only go up if molecule moves from early clinical phase to advanced phases in commercial. We have a lot of hope, opportunities and we are also putting best efforts to grow this division. And we are also confident because of the product pipeline which we are working with our partners. So this division will definitely grow but you cannot quantify this division based on quarter-on-quarter because of the supplies do happen in one lot. As you have seen in Q4FY20, our revenue for this division was almost Rs.150 crores because of supplies of a commercial product. And we will have similar supplies in Q4 of FY'21 also, because that customer will take between January and March commercial supplies. Because of the opportunities we see, we created 100% subsidiary for this division. We acquired asset in the form of a facility to give more focus and flexibility to the division. We feel we are in a right position and we are moving in the right direction.

Aakash Manghani: Could you talk about what is the profitability in the segment? Some of your listed peers report profitability in excess of 40%, 50% in that range.

Dr. Satyanarayana Chava: We run profitability with division wise but we cannot share those details.

Aakash Manghani: But it would be the most profitable segment for you by far?

Dr. Satyanarayana Chava: Yes.

Aakash Manghani: Like the corporate average is 29% in this quarter, this would be way higher I am assuming?

Dr. Satyanarayana Chava: Yes, absolutely right.

Aakash Manghani: And should we assume that based on the opportunities and the commercialization of the products that you are looking at of the 47-products, I mean, it could be in the vicinity of Rs. 800-1,000 crores of revenue in the next three to four years in this vertical itself?

Dr. Satyanarayana Chava: We are not giving guidance, but products have a lot of scope to generate significant revenues if they move from early clinical phase to commercial phase.

Aakash Manghani: Any focus you have between biologics or the patented side of regular pharma or it is nothing of that sort?

Dr. Satyanarayana Chava: We have molecules in different therapies.

Moderator: Thank you. Ladies and gentlemen due to time constraint, we take that as a last question for today. I would now like to hand the conference back to the management for their closing comments.

Dr. Satyanarayana Chava: Thanks, everyone for very interesting questions on the gross margin, EBITDAs and future growth, ARV opportunities etc. Thanks, Chirag and Kotak team for organizing this conference call.

V V Ravikumar: Thank you.

Moderator: Thank you. On behalf of Kotak Securities Limited, we conclude today's conference. Thank you for joining. You may now disconnect your lines.