“Laurus Labs Ltd’s Q2 FY’21 Results Conference Call”

October 30, 2020

Moderator: Ladies and gentlemen, good day and welcome to Laurus Labs Q2 FY'21 Results Conference Call hosted by Kotak Securities Limited. As a reminder, all participants lines will be in 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 now hand 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 and CEO; Mr. V V Ravi Kumar --ED and CFO and Mr. Monish Shah from the Investor Relations Team. I now hand over the call to Dr. Satya for his opening remarks. Over to you, sir.

Dr. Satyanarayana Chava: Thank you, Chirag. Thank you, everyone and a very warm welcome to our Results Conference Call for the Q2 and H1 FY'21. I hope everyone, their family members and colleagues are safe during this pandemic.

Our manufacturing units, R&D center and corporate office all function normally during the Q2 FY'21. At Laurus Labs, we are committed to protecting the health and wellbeing of our employees and their families. And we continue to implement rigorous safety and hygiene measures across all our locations. I am very thankful to our colleagues for rising to this challenge and ensuring business continuity as usual.

Moving on to our Q2 FY'21 Revenues: Revenue stood at Rs.1,139 crores, showcasing a robust growth of 60% percent year-on-year for the quarter and 67% for the H1 FY'21 year-on-year.

To begin with, I would like to share my updates on our Formulations Business. The Formulations division reported its highest revenue for the quarter of Rs.452 crores, showcasing a growth of over 180% year-on-year and a revenue of Rs.804 crores for the H1, showcasing a growth of over 200%. Interestingly, the revenue contributions from FDF segment has improved to 40% of the revenues for the quarter as against 22% in the Q2 FY'20. The growth driver for the Formulations business remains our LMIC business in partnership with the Global Fund, PEPFAR and other in various country opportunities.

During the quarter we also launched TLE400 in the LMIC markets and we expect to generate good revenue in the coming quarters from this launch. Apart from the LMIC business, we also see good growth in the developed markets of North America and Europe.

During the quarter we launched TLE in US. And the demand for Hydroxichloroquine remain very soft after WHO halted global trials. We do not foresee an increase in demand for HCQS in the coming quarters as well.

In other products, we continue to maintain our market share of Q1 FY21, especially in Pregabalin. In order to leverage our front end operations in US, we commenced marketing of in-license products as well. Today, we have eight final approvals, and eight tentative approvals out of 26 ANDAs filed so far.

In Canada, we have five approvals, and we have launched three already, and we expect to launch two more in this financial year.

As far as the European market is concerned, we are very happy to share that the contract manufacturing opportunity for certain non-ARV formulations is doing very well. We have a very robust order book for FY'21. Besides we are also in process of launching our own products in the European markets under our own label. We launched two products and we expect to launch one more in the current financial year.

With the robust order book, we continue to invest in our FDF infrastructure to augment capacities. We have undertaken debottlenecking as well as capacity enhancement. We are also expecting this debottlenecking will give some additional capacity partially in Q3FY21 as well as in Q4FY21. Our Brownfield expansion will be available to us in a phased manner over the next financial year.

On R&D front, we continue to invest in our FDF business. Overall R&D, we have spent 4% of our revenue in the H1 FY'21. So far, we have filed 26 ANDAs in US, 9 dossiers in Europe, 12 in Canada, and 8 with WHO, and 2 dossiers in South Africa and several dossiers in various other markets.

As we speak, we are always committed to expand geographies for existing products. So we continue to invest in that passion.

When it comes to generic API, our ARV API business recorded a healthy growth of 20% quarter-on-quarter, and also, we did better in our H1 FY'21. The growth was led by higher volumes of Tenofovir and Efavirenz. Along with this, we also saw higher sales from our external customers for Dolutegravir and Lamivudine. We also see healthy growth of second line ARV APIs in the Q2 FY21.

As indicated earlier, we expect the segment to deliver good growth this year, and we expect to achieve highest ARV API sale this financial year, surpassing the previous record.

We are also very happy to share that our Oncology API also recorded more than 40% growth year-on-year and 31% for the first half of this year. The growth was led by our key product, gemcitabine and other oncology products also shown very robust growth.

As we mentioned, we have one of the largest high potent API capacities in the country. When it comes to Other APIs, we have seen a 18% growth for this quarter year-on-year and 80% for the H1 FY'21. The growth in the segment was driven by higher volumes of existing products, contract manufacturing for our European partner.

We have also seen certain amount of dedicated capacities for select opportunities in Diabetic and Cardiovascular segment, which will enable us to grow this business beyond what we have grown now.

We have a very healthy order book for Contract Manufacturing of several generic API. On the back of sizable order book, new product opportunities and expanded capacities available gradually from this quarter onwards, we are very optimistic about the growth of other API.

We are also planning to add several new manufacturing plants in the existing units to meet growing demand for our API business.

Synthesis business recorded a growth of 36% year-on-year and similar number for H1 FY'21.Currently, we have about 50 active projects, out of which four are commercial. As you are aware, we have incorporated a newly owned subsidiary, called Laurus Synthesis Private Limited. This was done in order to give the business and increased focus. And eventually, we are also in the process of setting up a dedicated R&D and manufacturing sites. The proposed Synthesis R&D will come up at IKP, Genome Valley at an investment of Rs.60 crores and will be operational by end of next calendar year. A new manufacturing site for this division will also be a Greenfield project at Vizag which will cater to the manufacturing needs of this division for the next several years. This site will have capabilities to handle steroids hormones, high potent molecules apart from our large volume products.

With that I would like to hand over to Ravi to share Financial Highlights.

V V Ravi Kumar: Thank you, Dr. Satya and very warm welcome to everyone on our Q2 and H1 FY21 Earnings Call. Total income from operations for the quarter is at Rs.1,139 crores as against Rs.712 crores, registering robust growth of 60% (Y-o-Y)and for H1 we did about Rs.2,113 crores against Rs.1,263 crores, growth of 67% (Y-o-Y).

With a better product mix, we have seen an improvement in the gross margin.. Our EBITDA margin came at 31% for H1FY21 and growth in EBITDA was mainly because of operating leverage and better product mix.

Our diluted EPS for the quarter is at Rs.4.50 and with a growth of 309% and Rs.7.70 for H1 FY21 growth of 492%. Our ROCE improved to 37% on annualized basis. This is because of the higher asset turn and the operating leverage, etc.,

On the CAPEX front, we invested about Rs.262 crores in H1FY21. This includes the capital work-in progress, the some of the production blocks which we have spent out of the Rs.262 crores will be operational in the Q3 and Q4.

We have many business opportunities for the rising demand and various all segments. So, in order to meet those demand, earlier we had budgeted Rs. 700 crores of CAPEX in FY'21 and '22. we have revised our estimates to Rs.1,200 crores for CAPEX for these two years. Majority of the CAPEX will be spent in Brown Field expansion. Apart from it, as Dr. Satya communicated, for Synthesis one R&D center, one manufacturing block and one green field unit for FDF business in Hyderabad in order to de risk our business. And we also want to have another manufacturing plant for an API division in Vizag. This is how we are expanding ,and we are expecting around Rs.1,200 crores at this juncture.

And based on the performance of the company, board of directors declared interim dividend of Rs.0.80 per share of Rs.2 face value.

And one more point we want to highlight here. One of our directors Dr. Raju Kalidindi who resigned almost 3years back has requested for a reclassification of his category from a promoter to non-promoter. And based on approvals we have sent a notification to stock exchanges yesterday.

I Request the moderator to open for questions. Thank you.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question-and-answer session. We have a first question from the line of Nikhil Mathur from Ambit Capital. Please go ahead.

Nikhil Mathur: What I am trying to understand the growth momentum on the API side of the business? Is it sustainable into second half in FY'22? The reason I ask this is that we are getting some indication from some of the larger peers that a lot of global customers are still stocking onto inventories because they are wary that there can be a second wave of lockdown in various parts of the world. So I wanted to understand how sustainable is the sales space that have been recorded in first half especially on the API side of the business?

Dr. Satyanarayana Chava: Our sales of API also one of the highest in the Company's history. And we have not seen our customers are stocking these APIs because of continued challenge on the COVID front. We have highest ever order book so far in the company's history, and we have highest sale done so far. Based on this, we do not think that our customers are stocking our APIs. In fact, we have a lot of back orders for several APIs right now. We do not see that challenge here. Based on the order book what we have, we expect to grow our API better than what we have done between Q1 and Q2. So Q3 and Q4FY21, we will see more revenue coming from our API division based on the current forecast what we have including our order book.

Nikhil Mathur: And sir, in the opening remarks, you had alluded to that Tenofovir is seeing quite a bit of growth among the frontline APIs. Now, for instance, if say, supposing in FY'22, Tenofovir and Efavirenz that growth subside or in some certain cases a decline, are there second generation APIs like Ritonavir, Lopinavir ramp up is on track to counter any sort of sales decline from the front line APIs or lack of growth from the front line APIs?

Dr. Satyanarayana Chava: We are seeing decline of only Efavirenz in the next financial year. We continue to expect Tenofovir, Dolutegravir, Lamivudine, volumes will continue to grow. In fact, we are increasing our Tenofovir capacity significantly from what we have right now. And we are also planning to increase our Lamivudine capacity also significantly from what we have apart from Dolutegravir. So we are increasing our capacities because we have visibility, how much our customers are looking at and what is the growth in this segment. We expect Efavirenz will decline whereas other first line APIs will continue to grow.

Nikhil Mathur: Another question I have on the CAPEX side. Sir, I mean, over the last couple of quarters or so given the stellar run that the company has seen, your CAPEX guidance has been rising. I mean, a very fundamental question, what has really changed over the last couple of quarters or so dramatically that you are having to almost raise your CAPEX guidance by 70%, 80% in FY'21 and '22? Surely, COVID has had some role to play, right, I mean, else why was not this visibility say a couple of quarters back?

Dr. Satyanarayana Chava: A couple of quarters back, we were somewhat conservative in putting CAPEX. Right now, all our manufacturing plants are running at optimum capacity. And for us to grow in all these segments, both API, formulations as well as custom synthesis, there is a need for us to invest more to satisfy our current customers to service our current order book. That is the reason we increased CAPEX significantly.

Nikhil Mathur: What is the pricing outlook on the ARV side and formulations? Now, historically, we have seen that in the previous generation ARV formulations, there is usual pricing decline that keeps happening in this case. So what is the current pricing outlook from a one year, two year standpoint as far as the ARV formulations are concerned?

Dr. Satyanarayana Chava: Since we became an integrated player in ARV formulations, we believe we will have ability to weather the pricing challenges. If there is a pricing challenge, if you observe our gross margin growth, we are able to grow our gross margins despite some challenges in ARV formulations pricing because other businesses continue to deliver very good gross margins as we expected.

Moderator: Thank you. The next question is from the line of Sachin Shah from MK Investment Managers. Please go ahead.

Sachin Shah: At least I believe that last couple of years everything that you have been aspiring, thinking working hard for, seems to be culminating and falling right in the place and I would think very deservingly so, so congratulations. Sir, when I look at the more holistic sort of our business mix, say about say two, three years back we were a largely an API company. And if I see today we are almost balanced kind of API versus formulations even in terms of revenue breakup, maybe we will be about 50% to 60% of API, maybe 40% to 50% formulations. So we have done this transformation quite well, I would say. But, there are a couple of things which I would like to get your sense that are you looking at transforming that part of the business also? So two points; one is that if I look at our business, even today roughly about 80% of our revenue probably comes from the LMIC from the region and maybe 20% comes from the developed markets. So over a period of next three, four years, how do you see this mix changing? That is first. And second, even if I look at the overall dependence on the ARV products, so even today, I think, including developed markets, LMIC, all markets put together, including API, formulations, everything but ARV as a product is probably giving us about maybe 75%, 80% of our revenues and the other products are about 20%-odd. How do you see this two mix is changing over a period of next two, three, four years, what is your vision on that side?

Dr. Satyanarayana Chava: I will give the journey of what we have done so far, that will give you a perspective. From FY'16, 82% of our revenues came from antiviral APIs. And that went down to 34% for the H1 FY'21. When you look at the LMIC driven revenue for APIs and formulations put together, it is 60%, not 80% as you mentioned. So 60% of revenues coming from ARV APIs and formulation put together, remaining 40% coming from non-ARV from the developed markets. So our oncology continue to contribute 7%, other APIs contributed 11% in the H1, and our Custom Synthesis business continue to generate 10%. So if you look at, 30% of our revenue came from Oncology, Custom Synthesis and other APIs. In the Formulations business, 38% contributed in H1, out of that roughly 8% came from Europe and US market. So you look at that way, and see that, 60% is ARV-driven and 40% is non-ARV driven. That will change in the next two years, maybe 50% will come from ARVs and 50% from non-ARVs.

Sachin Shah: And sir, what about the mix of LMIC versus the developed market, how do you see that moving?

Dr. Satyanarayana Chava: I would put the same number.

Moderator: Thank you. We have a next question from the line of Sudarshan Padmanabhan from Sundaram Mutual Fund. Please go ahead.

Sudarshan Padmanabhan: Sir, two questions from my side; one is, we talked about the TLE launch both in the emerging markets as well as the US markets. If I look at the sale, is there any kind of bunched sales in the formulations that we are seeing in terms of ceding in for the requirements for more than probably one quarter or so, I mean, just to understand whether this kind of be it in formulations is something which is not without any one-off and something which is, fair in terms of you delivery is concerned? Second, sir, in terms of working capital, while the gross profit and the EBITDA has been phenomenal, we have cumulatively done about 650 crores of EBITDA, but if I look at the EBITDA to cash conversion, I mean, we have done something like around Rs.336-odd crores of cash post-tax. So, conversion seems to be lower primarily because of higher inventory. Is that inventory primarily built for TLE400 and that inventory should start coming down as the inventory gets liquidated?

Dr. Satyanarayana Chava: As of now, our inventory of TLE is very insignificant, actually we have back order, so, there is no inventory of TLE400 for LMIC and US market so that you can remove from your apprehension, and there is no inventory buildup. Our overall inventory buildup is because of our Dolutegravir capacity expansion, Lamivudine and Tenofovir. When it comes to the cash conversion, I will ask Ravi to answer the question.

V V Ravi Kumar: For the September ended, we have NWC of 172-days which is consistent with Q1 and Q2. In fact, Q2 is in a better shape. We are not seeing any inventory buildup. Coming to the EBITDA to cash, because in order to take into consideration, whether growing at a 60% level, so the inventory increase will be proportional to the 60% growth. If you give certain consideration at this point**.**

Sudarshan Padmanabhan: And would the intensity of working capital come down as we move up the value chain?

V V Ravi Kumar: We think it can be maintained at this similar level. If you compare with the industry, we are not worse off, we are comparable with the industry. And when we moved towards formulations where most of our formulations are backward integrated with APIs, so, we need to maintain these kind of inventory levels.

S Padmanabhan: On the question on formulations, I mean, how sustainable is it, and as the capacity come, do we expect to see growth even from the second quarter numbers, I mean, given your visibility in terms of order book and demand?

Dr. Satyanarayana Chava: In Q3, we are getting our debottlenecked capacity available only in the month of December. So, we see some growth in Q3, but the capacity enhancement will be visible in Q4. So, we still expect growth in Q3 and Q4 will see even bigger growth than what was in Q2.

Sudarshan Padmanabhan: And from a longer-term perspective, given the strong demand that you talked about, I mean, should we assume that even from these annualized level, say FY'22, '23, '24, I mean, with the capacity is also coming in, we should be able to do at least 15% to 20% CAGR in this formulations side?

Dr. Satyanarayana Chava: We are creating capacity to meet that kind of growth. So I will leave at. Since we are not giving any guidance, what we are doing, we are adding about 30% more capacity in APIs from now to next 18-months. That means we are adding about 1,500 kilo liters of capacity. And we will add about 5 billion more tableting capacity from now to next 18-months in the formulations side.

Sudarshan Padmanabhan: And how much would that be sir as a percentage?

Dr. Satyanarayana Chava: We are adding maybe 80% more capacity than what we are having currently in formulations.

Sudarshan Padmanabhan: And there is no one-off sales or supply in this quarter as far as the formulations or APIs are concerned?

Dr. Satyanarayana Chava: I want to make it clear. We have not added any new product. We have not added any new customer. We have not generated any revenue from new product. So we are very clear that there is no one-off in Q1, there is no one-off in Q2. This growth is led by increased volumes of our existing products from existing customers.

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

Tushar Manudhane: Just on this formulation side, so what will be the current gross block with this debottlenecking and all that will happen?

Dr. Satyanarayana Chava: Current gross block will be around Rs.500 crores and we have plans to invest about little over Rs.300 crores in the same site to expand capacity. Debottlenecking, we are spending about Rs.60 crores and we are getting about a billion-tablet capacity extra.

Tushar Manudhane: So just to make it clear, so 550 crores or the 5 billion and then incrementally 60 crores for another 1 million, and then another 300 crores to double the capacity or rather increase the capacity by 5 billion, correct?

Dr. Satyanarayana Chava: Actually, when I said around 500, that includes our capital outlay for debottlenecking as well.

Tushar Manudhane: So given this asset turn of 3x, safe to assume that kind of an asset turn for the upcoming CAPEX as well?

V V Ravi Kumar: When the asset gets mature, probably you may get this kind of a level, but when you start 5 billion capacity, you cannot get in day one.

Tushar Manudhane: No-no, of course, over a period of two years?

V V Ravi Kumar: Yes, but you have to take into consideration even the API investment also. Today, our average asset turn is 1.5, right?

Tushar Manudhane: I was specifically looking for formulations asset turn?

V V Ravi Kumar: If you are asking an incremental, probably, you can take it as 2x.

Tushar Manudhane: And secondly, currently, the formulations composition would be how much, ARV, US, ANDA and then specific European customers for the quarter?

Dr. Satyanarayana Chava: As we mentioned, our distribution of revenue coming from LMIC and other developed markets is 75% and 25% from developed market approximately. And that number is almost constant for the last few quarters, and we expect that will continue.

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

Cyndrella Carvalho: Just want to understand our positioning in Tenofovir and Lamivudine. If you could help us understand in terms of our global positioning, and is there any benefit that we are receiving today, or is there any global supply chain disruption which these two names are facing? And how do you anticipate going ahead from a capacity expansion plan as well?

Dr. Satyanarayana Chava: In the ARV, the PEPFAR first line therapy is Tenofovir, Lamivudine, Dolutegravir and we are expanding capacities of these three APIs significantly. And because of our scale, and backward integration, we expect we continue to gain market share, and we continue to maintain our margins in ARV APIs because of these things.

Cyndrella Carvalho: Any color in terms of what could be our market share in these two names?

Dr. Satyanarayana Chava: In the Tenofovir, we expect to have more than one-third of market share in APIs. I am not adding formulations what we are doing. And the Lamivudine, we do not have one-third market share. But we are aiming to get more than 30% market share once the new capacity expansion comes live. And Dolutegravir, we have 30% market share as API.

Cyndrella Carvalho: And sir, if you could help us understand, is there any kind of supply disruption in the global supply chain in these three API side, which could benefit us right now or going ahead?

Dr. Satyanarayana Chava: We have not seen any supply disruption in these APIs with respect to starting materials or with respect to intermediates and API. So our growth in APIs is primarily because of increased access. There were three million new patients added into treatment. And some of the non-integrated

players are getting approval using our API. So, these are the two main reasons for growth in this segment, not because of any disruptions in the supply chain.

Cyndrella Carvalho: Our own formulations also must be contributing, is thatcorrect understanding?

Dr. Satyanarayana Chava: We are supplying API through formulation. But that API is not counted in our market share. When I said our market share in API as a third-party API sale, I did not consider our supply to formulation in that number.

Cyndrella Carvalho: We have seen these extraordinary numbers and the growth trajectory is on a different league altogether. So would you be able to help us understand for FY '22-23 in terms of the segments that we operate, what should we model to understand the growth trajectory and margin effect would be slightly helpful?

Dr. Satyanarayana Chava: We are continuously expanding our manufacturing footprint in all these segments, and we expect to grow from the current levels with good growth. And we also expect to maintain our profit margins because of operational leverage, because of manufacturing efficiencies, we expect to have good growth in our top line.

Moderator: Thank you. The next question from the line of Nimish Mehta from Research Delta Advisors. Please go ahead.

Nimish Mehta: I am just trying to understand from a broad perspective, the growth that we have seen in the formulations business, is it because of the increased demand in the country that we are targeting or it is something else, like, what is the genesis of the growth, if you can explain that will be very helpful?

Dr. Satyanarayana Chava: Growth in formulations, there are two factors here; one is growth in our ARV formulations share, primarily because of market itself expanded with a number of millions of people accessing the ARV treatment, that is one. And second, our contract manufacturing revenue from Europe is also increased. And we are also launching our products in Canada, our products in Europe and the US. So the growth is coming from these two segments; the growth in patients accessing the ARV treatment and launch of more products in more geographies.

Nimish Mehta: Just to delve a little bit on that, you mentioned that growth in those ARV is basically with the expansion in market, generally we would think that in times when there is a pandemic crisis, the treatments are generally not seeing any increase especially the anti-infective treatment or infections treatment. So, is there any specific reason why more patients are getting treated for antiretro for HIV, even in a situation like this where usually other doctors are not operating and most of them are actually only working for COVID patients?

Dr. Satyanarayana Chava: During this pandemic, there is a slight shift in dispensing pattern. More countries move to multi-month dispensing rather than every month dispensing. Either they are giving three packs of 30

or they are giving a pack of 90 for the patient. So patients did not come and see the dispensary or a doctor frequently. So that shift happened.

Nimish Mehta: In a way there is more stocking per patient which is happening because of COVID and that is one of the reasons driving the growth in the ARV market, is that a fair understanding?

Dr. Satyanarayana Chava: There is no stocking up. So, whenever the patient comes, instead of he get one pack of 30, he is getting two or three packs of 30, so that you may not come to the dispensary quite often during this crisis. There is no stocking of the inventory. So they started buying more of multi month dispensing right now. So there is no stocking up.

Nimish Mehta: But in terms of the number of new patients getting added, that may be a normal factor, may not be any significantly different, right?

Dr. Satyanarayana Chava: In the last 12-months, all these countries and agencies were able to add 3 million new patients into the treatment. That was primarily because of the development goal of 90-90-90, that is 90% of the people who are aware should get treatment and 90% should have viral reduction. In fact, people want to revise it to 95-95-95, that means more people will now have access to the HIV treatment. Early, the treatment, the minimum the new infections, that is the kind of the message these global agencies are propagating. We expect the number of patients will continue to increase current year and year after as well.

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

Nitin Agarwal: Sir, just continuing on the ARV business, just to help understand a little better, so the market shift which is happening in this largely a TLE to TLD market shift. We were already strong in the TLD segment earlier. So the growth, which is happening in the business now, are we getting market share in general in the ARV market versus what we were two years back?

Dr. Satyanarayana Chava: You are talking about the formulations or API?

Nitin Agarwal: Put together, I mean, because today we are almost give or take with the API and formulation put together is Rs.3,000 crores of ARVs at a current rate versus a 1,500 crores API business we used to do earlier. So obviously the market has not expanded as much. So has it just been a very significant market share shift that we have got as that regime has shifted from TLE to TLD?

Dr. Satyanarayana Chava: You are right, we have absolute leadership position in Efavirenz, but Efavirenz is moving to Dolutegravir, three things happened; one is earlier we were selling more Efavirenz, less of our drugs, now we are selling all three components of the preferred treatment, that is Tenofovir, Lamivudine, Dolutegravir, and also we are getting formulations sale in the TLD and we were the third Company to get approval. Although there were eight approvals right now, we continue to enjoy market share because of our backward integration, because of our ability to supply on

time, and we are able to price at very cost effectively. So, you are right, our market share when you club both API as well as formulations, it is very good right now.

Nitin Agarwal: What share would we have the total TLD market today from API perspective and from a formulation perspective in both the categories put together?

Dr. Satyanarayana Chava: We are at 20% of TLD market share ex-South Africa on the formulations side.

Nitin Agarwal: And sir on the APIs?

Dr. Satyanarayana Chava: API side, maybe you can add another 10%, 15%.

Nitin Agarwal: 30%, 35% of the TLD market, we are present either through API or through formulations.

Dr. Satyanarayana Chava: That is a good assumption, yes.

Nitin Agarwal: And how much can we scale this thing from here on?

Dr. Satyanarayana Chava: I think we expect to remain at that level but what we need to consider is the number of people accessing treatment will go up. Even we remain at that percentage, the base will grow.

Nitin Agarwal: Secondly, on the US market, when you take a three, five year view of the business, what are the big opportunities in the US for us in terms of, is it going to be the same, I mean, we obviously done a few ANDA filings from P4, filings, but is it just market share gain in these launches or there are some larger sort of products which can meaningfully impact the US business growth for us in next three to five years?

Dr. Satyanarayana Chava: We expect to see significant jump in US because our new product approvals will come next year. We do not have very large products launching this financial year. We will have some significant launches in next financial year.

Moderator: Thank you. The next question is from the line of Aakash Manghani from BOI AXA Mutual Fund. Please go ahead.

Aakash Manghani: A couple of questions to start with. This CAPEX that you highlighted of Rs.1,200 crores, by when will this get commercialized and by when do you expect to operate at maybe 80% 90% or more utilization on this expansion?

Dr. Satyanarayana Chava: The majority of the CAPEX will be operational by June 2022.

Aakash Manghani: For my benefit, if you could reiterate the split of the CAPEX within your three segments?

Dr. Satyanarayana Chava: Broadly, we are spending 40% in API, 40% in formulations and 20% in synthesis, that is the broad number you can take.

Aakash Manghani: How would you be funding this CAPEX of this entire Rs.1,200 crores?

Dr. Satyanarayana Chava: It will be done mostly from internal accruals. That is the one reason where we are not planning to reduce our current debt and we want to invest our cash profit we get into either funding working capital or creating more infrastructure.

Aakash Manghani: In your estimate, once this gets commercialized by June '22, it will take you about two or three years to utilize it completely?

Dr. Satyanarayana Chava: Out of these CAPEX majority is being done Greenfield. So we do not anticipate that much delay in generating revenue from this new capital expenditure.

Aakash Manghani: What would be the sort of revenue mix that you may achieve say two years down the line after commercialization of this CAPEX? Today, as of H1 API is 52% formulations is close to 40%? How would this look at look by FY'24 or so?

Dr. Satyanarayana Chava: The percentage should remain broadly the same. So 40% coming from formulations, may be 40%-odd coming from APIs and remaining coming from Synthesis. We do not see that percentage changes significantly, but the base will increase significantly from the current levels.

Aakash Manghani: So that means your profitability that you achieved in this quarter or the first half, I do not know what base should I consider, but would that be similar two years down the line, EBITDA margin percentage was 32%, 33% in this quarter, if the sales mix were to remain similar in next two, three years, I mean, would you be able to sustain this level of profitability?

Dr. Satyanarayana Chava: We hope so.

Aakash Manghani: So thereby your ROCE profile should look in what range if you could sort of guide on that once this CAPEX is commercialized and utilized at the capacity?

Dr. Satyanarayana Chava: Current ROCE is very attractive, see, for H1, we had a ROCE over 37%, but that will come down because we are putting significant CAPEX in the next 18, 24-months, but we believe it will be industry best.

Aakash Manghani: And last question on the Synthesis bit. I mean, you mentioned that four molecules are commercialized, and you have a lot under development. Could give some roadmap as to how you want this business to shape up, because there is a lot of potential on the CDMO side of things, what is your vision for this side of the business?

Dr. Satyanarayana Chava: See, here, our growth in this division depends on how the molecules are performing in the clinical phase. We have several interesting molecules in various clinical stages. We are not anticipating all those will be successful or all those will be failures, but there will be a certain amount of assumptions we did on how many will succeed in going to the next clinical phase, and we have very interesting molecules in the development right now. That is the reason we are creating a dedicated R&D and we are in the process of creating a dedicated manufacturing site to give them flexibility to take projects or increase the number of projects what they currently handle.

Moderator: Thank you. The next question is from the line of Jeevan Patwa from Candifloss Advisors. Please go ahead.

Jeevan Patwa: So apart from your Custom Synthesis business, is there any Contract Manufacturing revenue in your API and FDF verticals?

Dr. Satyanarayana Chava: Yes, we have, see, our Contract Manufacturing of APIs or Contract Manufacturing Formulations is not considered in our Custom Synthesis business…

Jeevan Patwa: So how much would be that?

Dr. Satyanarayana Chava: Maybe 20% of our revenue coming from Contract Manufacturing...

Jeevan Patwa: So that includes Custom Synthesis, right?

Dr. Satyanarayana Chava: Apart from Synthesis, say, about 10% revenue of our overall API revenue coming from Contract Manufacturing, and 10% of our formulations is also coming from Contract Manufacturing. So the 20% of our revenue is coming from Contract Manufacturing of generic APIs and Generic Formulations and about 10% of our revenue coming from Custom Synthesis. So if you look at our overall revenues coming from Contract Manufacturing, and Custom Synthesis, is close to 30% of our overall revenue.

Jeevan Patwa: That is something similar to what Divi's also does, right? So another question I had was, I look at Laurus Labs as a process innovator. So Laurus has actually done it in the past successfully, done it for Efavirenz and then it had done it for Dolutegravir as well, it has done it for Metformin as well. So, if I look at say next three to four years, which are the large APIs where you are basically targeting for this process innovation, and you want to be the cost leader in those APIs. If you do not want to disclose the name, you can just tell me what kind of size of API you are looking at?

Dr. Satyanarayana Chava: We have 25% more market share in seven APIs that we make, and we want to expand that number to 15 APIs where we would like to have 25% or more global market share in the next three years.

Jeevan Patwa: What would be those APIs if I can ask -- are they like billion dollar plus kind of APIs?

Dr. Satyanarayana Chava: There is no API sale which is billion dollar. So there are very large volume APIs. Maybe each of these APIs will have the ability to generate $10 million or more. When I am saying global leadership, we are not talking about 100% leadership and only generating one million revenue, what we are talking about is leadership on large volume APIs.

Jeevan Patwa: And there you will have the formulations also, right, the vertical integration you will have there?

Dr. Satyanarayana Chava: Majority of those will have formulations but some of them may not have.

Moderator: Thank you. We have next question from the line of Naresh Suthar from SBI Life Insurance. Please go ahead.

Naresh Suthar: Sir, my question is around the CAPEX plan which you highlighted. You said your formulations facility will go up by 80%, 5 million tablets. So just wanted to know to utilize this facility, what are the drivers, like are these the LMIC-driven ARV or these are developed markets like US and Europe, so which are the key market to utilize these…?

Dr. Satyanarayana Chava: The expanded capacity in formulations, majority of that will be utilized for Europe and US.

Naresh Suthar: And for that, I mean, the ANDA pipeline which you have built, that will be the key for this utilization, right?

Dr. Satyanarayana Chava: Yes.

Moderator: Thank you. We have next question from the line of Ritesh Rathod from Nippon India Mutual Fund. Please go ahead.

Ritesh Rathod: Can you help me how dispensing of ARV medicine has changed this COVID in LMIC countries, like on ground level?

Dr. Satyanarayana Chava: What we believe from the reports and also commentary given by these agencies, they are gradually moving from single month dispensing to multi-month dispensing. So they Are moving from a bottle of 30s to a bottle of 90s and 180s. So that people will have to come to the dispensaries fewer times.

Ritesh Rathod: When 3 million new patients got added, what was the base on which it got added?

Dr. Satyanarayana Chava: These are the new patients who were enrolled to receive antiretroviral treatment.

Ritesh Rathod: So what would be the base, I mean, was it annual addition?

Dr. Satyanarayana Chava: When they are added into the treatment, they continue to be on treatment. So assuming 3 million new patients added, that means there will be 36 million bottles of some kind of treatment is required. That means 3 million into 12 months. So they will need 36 million bottles of some kind of ARV treatment.

Ritesh Rathod: And you spoke about the target of 90-90-90 for reaching that HIV of WHO target. So where they are in the journey, can you give us some idea according to your estimate?

Dr. Satyanarayana Chava: Right now, they are not at 90-90-90, some countries achieved the target, but some countries falling behind the target, but there is a great progress done. So, if you multiply 90x90x90, about 72%-odd has to get the viral load suppression, but that is about 62% right now. So when you compare 62% to 72%-odd still there is a gap there. So there is enormous need of HIV medication to reach that 90-90-90 goal, but UN, they want to revise that target to 95-95-95 with an aim to reduce the number of people dying because of HIV to less than half a million per year.

Ritesh Rathod: And since you said you are the third player who got the approval status on supplying this formulations, how many new players have got added till now?

Dr. Satyanarayana Chava: Ten active players in HIV. Some of them are fully integrated, some of them are partially integrated, some of them are not integrated. So there are 10 companies active in HIV space in the LMIC markets.

Moderator: Thank you. We have next question from the line of Harith Ahamed from Spark Capital Advisors. Please go ahead.

Harith Ahamed: Earlier, we had talked about an aspirational market share of around 15% in the LMIC first line ARV formulations market. So, could you give a sense of where we are in that journey towards 15% our current market share? And has there been an improvement versus what our share was in FY'20?

Dr. Satyanarayana Chava: In FY'20, our Formulations sale itself is not that significant, but we expect to maintain this market share, and our base will increase as the number of people accessing the treatment will increase.

Harith Ahamed: Have you reached that 10% share mark already or we are moving towards that?

Dr. Satyanarayana Chava: In first line, we believe we are at 15% market share right now.

Harith Ahamed: And on the API front, I believe you said you are seeing strong growth in our external sales of Tenofovir, Lamivudine and other frontline APIs excluding Efavirenz. So here again, the question is whether our share has increased in these APIs or has the growth been driven by an expansion in the market for these APIs, so I was just trying to understand that?

Dr. Satyanarayana Chava: We also have very good market share in the first line APIs for third party API sales. If we put both API and formulations in the first line treatment, we have very good market share and we expect we continue to retain that market share despite the growing number of people accessing the treatment.

Moderator: Thank you. The next question is from the line of Krish Mehta from Enam Holdings. Please go ahead.

Krish Mehta: I had two questions; the first is, can you tell me how much incremental revenue this quarter we got from TLE400, and 600? And the follow up to that is how much of this is just taking share, or is this one-time stocking in the local supply chain?

Dr. Satyanarayana Chava: We are not giving that minute details of the split between our revenues in TLE400, TLE600. We believe our growth in these revenues is not because of stocking. As I mentioned, we also have highest order book in the company's history. That clearly demonstrate there is no one-off in our numbers in Q2FY21.

Moderator: Thank you, sir. We have next question from the line of Sameer Shah from Valuequest Investments. Please go ahead.

Sameer Shah: My first question is apart from HCQS, do we have any other play in any of the COVID-related drug, whether APIs or filing?

Dr. Satyanarayana Chava: We are not there in any COVID-related API formulations. We don't have Remdesivir, or Favipiravir, or Dexamethasone. w W are not in any other therapy, except the HCQ. But as you are aware, the treatment based out of HCQ is the COVID maintenance is negligible right now. So, our revenues related to COVID treatment is close to zero.

Sameer Shah: Second question on the Custom Synthesis business, if you can give some more color in terms of what is our target segment, what are the kind of orders that we are targeting and stuff like that, what kind of a size in next two, three years do you want this business to become?

Dr. Satyanarayana Chava: In the Custom Synthesis business, we have specialized in, steroids and hormones, and second one is oncology and third one is large volume. I think we have projects in all three, steroids, hormones, we have several molecules in clinical phase in oncology, and we are also working on molecules where the capacity requirements are very large.

Sameer Shah: And if you can give some color on this, like you said US some significant approvals are expected next year, so what are these filing?

Dr. Satyanarayana Chava: I cannot give any specific details right now, we can only give details about what we have filed so far, but not the future filings, we can only give a number but not the specific names.

Sameer Shah: But these are in which segment, those also would be in oncology kind of segment?

Dr. Satyanarayana Chava: We are not filing any ANDAs in oncology for our formulations business. So these are non-oncology formulations.

Moderator: Thank you. We have next question from the line of C Srihari from PCS Securities. Please go ahead.

C Srihari: My question center around the dosages business. If you can just give the volume growth data both YoY and sequentially, overall LMIC and Efavirenz? And secondly, on this part itself, how do you look at the per unit realization going down the line over the next two to three years?

Dr. Satyanarayana Chava: In Efavirenz actually, there was a degrowth. So if you recollect our investor calls several quarters, I think most of the questions were related to Efavirenz and shift to DTG, at least I am happy that you asked this Efavirenz. Now Efavirenz revenues in the overall company's revenues are less than 10%, it used to be 50% earlier, now it is a single digit. There is a degrowth in volume. But our market share has gone up in Efavirenz because many people are not manufacturing, and we became the preferred supplier. Still, it is an interesting product for us, but other molecules are growing, so the percentage of revenues coming from Efavirenz is going down. But as an absolute number, still it is an interesting product for us.

C Srihari: Sir, I wanted in our overall growth, what has been the volume growth, that is what I was asking?

Dr. Satyanarayana Chava: Efavirenz, there is a volume degrowth in fact.

C Srihari: Yes, I am asking about overall business and LMIC business?

Dr. Satyanarayana Chava: The volume in a sense, you are talking about API or formulations, Srihari?

C Srihari: I am talking primarily about Formulations, this 5 Billion tablets capacity that you have?

Dr. Satyanarayana Chava: Okay, formulations, the current capacity majority utilized for LMIC markets. For new capacity, what we are setting up, will be majority used for Europe and US.

Moderator: Thank you. We have next question from the line of Andrey Purushottam from Cogito Advisors. Please go ahead.

Andrey Purushottam: I had basically a question regarding, one, sustainability of margins which are very high, right, 33% and 22%, EBITDA and PAT margins? And going forward, I think you said somewhere during the call that the mix that we currently have of about 50-40-10 between these businesses is likely to remain similar in the near future? But if I misunderstood that, please correct me. And I also wanted to know, so how should we look at the growth rates in these three segments over let us say a two or three year period? And if you could advise me as to whether the formulations

business is essentially more profitable than the API business? And if that share is going to increase, can we look forward to an enhanced margin on account of that?

Dr. Satyanarayana Chava: All three divisions will continue to grow. In API division, the new growth primarily will come from non-ARV and Onco APIs. And in Formulations, the growth will come from both LMIC, ARV and non-ARVs in Europe and US. In the Synthesis business, as I mentioned, we are specialized in large volume, High Potent, steroids and hormones, all those will grow. I think if we look at where we generate significant margins is in Synthesis business, oncology, and non-oncology APIs. And when it comes to the ARV, APIs and formulations, since the volume is very large, we generate much higher asset turnover ratio.

Andrey Purushottam: So will these margins sustain sir?

Dr. Satyanarayana Chava: We expect so, the revenue growth will continue, and that will help us to have operational leverage, and also, our R&D spend in absolute term will remain around Rs. 160 to 170 crores, but as a percentage terms will go down and also our manpower cost will not grow proportionally to our revenue. So these will help us to maintain our EBITDA margins.

Moderator: Thank you. Ladies and gentlemen, we take the last question from the line of Ranvir Singh from Sunidhi Securities. Please go ahead.

Ranvir Singh: Just a few clarity, on LMIC market what you are selling is purely a tender business or you have some products outside tender also?

Dr. Satyanarayana Chava: LMIC is purely tender based and as we clarified in the previous calls, these tenders are not one-time tenders, these tenders are multi-month tenders. For example, we have visibility, what product we supply to which country in June 2021. That means that is the kind of visibility these agencies will give and tenders are not meant for next month sales. So, these are very long-term sustainable tenders, and in many cases, these tenders are not winner takes all, so, even the L1 will not get 100%. So, there is a sustainability built in, in the tendering process. Its evenly divided across the players based on their performance, quality, their capacity, their ability to meet short-term demand. These are various factors which influence these tenders and we are very comfortable right now with the order book and visibility what we have in the LMIC markets.

Ranvir Singh: You said 75% of our formulations is from LMIC, right?

Dr. Satyanarayana Chava: You are right.

Ranvir Singh: And on CAPEX side, you said Rs. 1200 crores would be in two years. So, this is from FY'21 to '22 or '22 to '23, how this is…?

Dr. Satyanarayana Chava: It is FY'21 and '22.

Ranvir Singh: What I am asking is that because we are moving from single month dispensing to multi-month dispensing. Does it anyway imply that we the clients would procure more at once means that there would be bulging of orders or bunching of demand for that ARV prescriptions?

Dr. Satyanarayana Chava: The shift is gradual. We also started supplying multi-month dispensing right now. So, I think there is no bunching up of orders. The orders what we have for the future is more for 90s and 180s rather than 30s. But currently we are still supplying large volume of 30s. So there is no bunching up of orders.

Ranvir Singh: In this business, what would be the contribution of supplies to us then?

Dr. Satyanarayana Chava: We cannot give you specifically, but that attained a peak level of our steroids and hormones. So the growth is coming from non-Aspen business.

Ranvir Singh: Aspen business is scalable from here or it has already reached its peak?

Dr. Satyanarayana Chava: Aspen business reached its peak and the growth in Synthesis business is coming from non-Aspen business.

Moderator: Thank you very much, sir. Ladies and gentlemen, that was the last question. I would now like to hand the conference over to the management for closing comments. Over to you sir.

Dr. Satyanarayana Chava: Thanks, everyone, for your interest in the company and also for putting very insightful questions. Some of these questions will help us to realign our priorities and interest to keep the entire stakeholders' value continuously growing. Thank you.

V V Ravi Kumar: Thank you.

Moderator: Thank you very much, sir. Ladies and gentlemen, on behalf of Kotak Securities, that concludes this conference call. Thank you for joining with us and you may now disconnect your lines.