"Laurus Labs

Q2 FY '23 Earnings Conference Call"

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MODERATOR: **MR. MONISH SHAH – ANTIQUE STOCK BROKING**

Moderator: Ladies and gentlemen, good day, and welcome to the Laurus Labs Limited Q2 FY '23 Earnings Conference Call, hosted by Antique Stock Broking. 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 star then zero on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Monish Shah from Antique Stock Broking. Thank you and over to you sir.

Monish Shah: Thank you. Good evening, and welcome to Laurus' Q2 FY '23 results conference call. We thank the management for giving us the opportunity to host this call. Today, we have with us Dr. Satyanarayana Chava, Founder and CEO; Mr. V.V. Ravi Kumar, Executive Director and CFO; and Vivek Kumar from the Investor Relations team. On behalf of Antique Stock Broking, I would like to wish the management and all the participants a very Happy Diwali. I will hand the call over to Dr. Satya for his opening comments. Thank you and over to you.

Satyanarayana Chava: Thank you, Monish. Thank you for joining us for our Q2 FY '23 and H1 FY '23 results conference call. We wish everyone participating in the call and their families very happy and safe Diwali. We are pleased to have this opportunity to update you on our progress and answer your questions. Our strong start to FY '23 continued in the second quarter.

Our H1 financial results demonstrate favorable change in our business mix and sustained profitability. This was despite ongoing disruption in the business environment due to continued pandemic situation and also emerging geopolitical issues. Q2 results were driven by continued strong growth in our CDMO business with additional support from Non-ARV API segments. Overall, FDF ARV division performance was subdued and was impacted negatively by lower formulation molecules and adverse pricing dynamics in both API and Formulation. Supply chain logistics scenario has slightly eased, driving moderation in imported RM prices. However, the ground situation remain extremely dynamic with the multiple factors in play, like restricted internal mobility in China, geopolitical issues.

We are trying to minimize any disruption to customer shipments by expanding our critical supplier base and also having enough inventory to cope up these challenges. As we enter into second half, we remain confident in strength of our businesses, which is expected to deliver a strong revenue growth and a stable EBITDA margins of around 30% for the entire financial year. However, in near-term, we'd like to provide you an update on our earlier goal of $1 billion revenue by FY '23 sales target, which could potentially get delayed due to changed competitive landscape and adverse pricing impact in ARV APIs and offtake in ARV formulations.

We remain firmly guided by our strategic priorities to build long-term growth. And our excellent execution skills will enable us to deliver value to all stakeholders. We are executing on the opportunities in front of us today, while simultaneously making the necessary de risking investments to sustain the company's success into the future.

Moving on to our financial results. We achieved a healthy top and bottom line growth for the quarter and the first half of FY '23, which was led by an exceptional growth in non-ARV numbers. We achieved INR 1,576 crores in revenues for the quarter, showcasing a 30% growth year-on-year. In the Generic FDF, for the quarter, our revenues were down by 70% year-on-year. For H1, our revenues were down by 51%. And our revenue degrowth was about INR520 crores when compared to H1 FY '22. However, our antiviral APIs have shown a healthy growth, INR 407 crores in quarter 2 versus INR 339 crores in quarter 2 FY '22. For the first six months, we did the INR 790 crores ARV API sale versus INR 752 crores in last financial year six months.

Oncology, de-growth was visible in our Q2 numbers, but this is momentary and we expect overall Oncology will have a growth by end of the financial year. Noteworthy to have to observe, our other APIs has grown significantly in the current quarter from INR 115 crores to INR 222 crores. In Generic APIs, overall, we did INR 680 crores versus INR 527 crores in Q2 FY '22. Our Synthesis was a very remarkable achievement here. We did INR 720 crores versus INR155 crores in Q2 FY '22. Our Bio results were almost flat, INR 27 crores versus INR 26 crores in FY '22. Overall, we did INR 1,576 crores sales for the quarter 2 versus INR 1,203 crores in quarter 2 FY '22, which was almost 30% more than the corresponding quarter last year.

I want to give you a brief on our Generic Formulations. This division reported revenues of INR 498 crores for the H1 of this financial year with almost 50% decline year-on-year. And for the quarter, it was exceptional de-growth of 70%.

When it comes to LMIC business in ARVs, the broader demand environment in ARV continue to stay softer and the pricing has remained very depressed in Q2, which is already at record low levels. We continue to remain calibrated in our bidding approach to ensure better profitability for this business. Having said that, we are optimistic about having a better H2 uptake with situation getting stabilized. We are very confident of sustaining our leadership position in first-line HIV treatment, both APIs as well as formulations.

During H1, we launched lopinavir-ritonavir combination in the US and also received US FDA approval for tenofovir-lamivudine combination in the second quarter, which we expect to launch shortly. Additionally, we are awaiting few more products approval which should drive our growth in coming years. Laurus is fully integrated player in ARV formulations and believe we have the ability to weather any pricing challenges in the coming quarters as well as we're able to maintain our margins in the future quarters.

Coming to the developed markets, our performance was stable and we continue to get good market share on some of the products. Increase in the generic volumes have been able to offset the pricing pressure. We continue to leverage our front-end operations in US for new product launches. During the quarter, we filed two ANDAs and received four approvals, two final and one tentative. We expect US filing pace to pick up during the second half of this year. Cumulatively, we have a total 34 ANDAs filed to-date, of which we have a total of 14 final approvals and 12 tentative approvals so far.

In Canada, we continue to have good approval base with 11 approvals on hand, of which we have launched seven products. In the Q2, we launched one product. And we intend to launch two more products in the rest of the financial year.

For EU markets, we have validated three products as part of our CMO partnership. We did one product in Q2, we got approval. We expect a significant upside from these products in the coming quarters. We have a basket of 10 approved products versus nine in the previous quarter, of which we already launched five products. We launched one new product in Q2. And we will be launching few more products in the rest of the financial year.

Based on our healthy product pipeline progress, we continue to invest in Non-ARV formulation development and infrastructure. We currently have commissioned the total capacity of 10 billion units during the quarter 2, we also wanted to make a note, there is a room to expand the formulation capacity by another 5 billion, but this may happen during the next financial year depending on how we are doing in Europe and US and how best we are utilizing our current infrastructure.

On R&D front, we continue to allocate critical resources to our initiatives and invest in portfolio with product-specific approach based on complexity and scale economies. We initially started with immediate release solid orals now we moved into modified release. We're also slowly moving up in the value chain by investing in complex generics.

We have developed a unique novel drug delivery for pediatric HIV and filed patents around each. We intend to file NDA for this novel pediatric product during the current quarter. We believe this drug product for pediatric HIV treatment could significantly enhance our position as a innovative cost effective solution provider in HIV treatment in LMIC and also provide opportunity for us to explore new therapeutic areas using this drug delivery system.

We're also happy to share that we have commissioned our sterile R&D. And currently, we have 30 scientists working there. Overall, our R&D spend to sales for the quarter was around 3%.

Going to Generic API, our anti-viral business during the quarter continued to witness healthy improvement with the sales growing by 20% year-on-year to INR 407 crores, while for the first six months, the growth was 5% year-on-year. Overall, demand stays softer and we expect volume and prices are going to stabilize around the current level. Onco APIs reported about INR 51 crores sales during this quarter, a decline of 30% year-on-year. However, for the past six months, the segment had a degrowth of 14% year-on-year.

This is a temporary phenomenon, in fact, we are very confident to increase our oncology sales significantly in the next six months. We are also increasing our capacity of Hi Potent manufacturing in our Unit 4 located in Atchutapuram to meet our continued demand for high potent APIs. Other API segment sales, which includes cardiovascular, diabetes and anti-asthma products have shown very good uptick, both for the quarter two as well as the first half of the financial year.

For quarter two, we reported the sales of INR 222 crores, growing 90% year-on-year. For the first six months, even now adjusting to a low base the growth is robust at almost 90% year-on-year, supported by new contract supplies. During the first half, we have filed one DMF for a non-ARV product. With that, the total DMF filed is 74 to-date.

We are also initiating validation for several APIs and expect to see a good filing in FY '24. We continue to have high order book visibility for non-ARV non-Onco APIs and additional manufacturing capacities also will support to capture the opportunity in this segment.

Synthesis again has delivered strong quarter, delivering a growth of over 300% year-on-year and 25% quarter-on-quarter and recorded a sales of INR 720 crores. During the first half of the financial year, our CDMO business have grown over 2.5x compared to the previous years. This growth was supported by solid demand from new and existing clients. We are very excited about this division and we are investing more in augmenting our capacity and R&D as well as manufacturing.

We have over 50 active projects at different stages and ongoing commercial supplies of 4 APIs and several intermediates.

Our greenfield investment to setup a dedicated R&D center for Synthesis division at Genome Valley, Hyderabad and three manufacturing units in Vizag under Laurus Synthesis Private Limited is progressing as per our previous timelines. New sites for this division will have the capabilities to handle steroids, hormones and high potent molecules apart from medium and large volume products.

Our Laurus Bio revenues were largely stable at INR 27 crores versus INR 26 crores quarter-on-quarter. But we do anticipate pick-up of new capacities with our large scale CDMO partners in the second half of this financial year. However, for H1, the sales grew 41% year-on-year. We believe alternate food industry is likely to grow meaningfully over the coming years. Scale, cost and functionality will remain core drivers for differentiation for the players. We want to capture this opportunity and would like to expand our capacity, both at R1 to have more R&D projects and also complete the investment in balancing equipment at R2 to do scale up of these projects from R1. We are also in the final planning stage to further expand our manufacturing capacity on a greenfield site in Karnataka itself. With that, I would like to hand it over to Ravi to share financial highlights.

V. V. Ravi Kumar: Thank you, Doctor. A very warm welcome to everyone for our Q2 and H1 FY '23 earnings call. Before starting anything, I want to wish a very happy Diwali, healthy, wealthy, safe Diwali.

Total income from operations for H1 is INR 3,115 crores against INR 2,482 crores, a growth of 26%. During the quarter, we have 31% growth with INR 1,576 crores against INR 1203 crores. Gross margin slightly decreased to 55.1%. This is because of the product mix and some of the lower prices in the ARV segment. Our EBITDA for Q2 was INR 449 crores with 28.5%, whereas for first half is INR 903 crores with around 29% margin. This has happened due to better division mix, the CDMO mix is being helping for this.

Our diluted EPS for the quarter is INR 4.30, a 16% growth and INR 9 not an annualized basis for H1, the growth of 10%. Our ROCE is stable at 28% on annualized basis. This is on the back of better product mix. On the CapEx front, we invested INR 416 crores in the first half. And we are broadly in line with our guidance for the two years around INR 2,000 crores across all the subsidiaries and divisions. And we remain on course to strengthen our position as a cost effective integrated pharma player.

We are investing in the backward integration program and creating more capacity. The additional investments in the capacities we are expecting will be in the non-ARV sites. On the quality to side, we are still bullish on the overall business of the company. The FDF ARVs are only and one-off kind of a thing in the second quarter and we expect it to restore from the quarter three onwards. So with this, I would request the moderator to open lines for the Q&A.

Moderator: Thank you very much. We will now begin with a question and answer session. Anyone who wishes to ask a question may press star and one on their touchtone telephone. If you wish to remove yourself on the question queue, you may press star and two. Participants are requested to use handsets while asking a question. Ladies and gentlemen, we will wait for a moment while the question queue assembles. We have our first question from the line of Jeevan Patwa from Sahasrar Capital.

Jeevan Patwa: I have three questions. Firstly, so earlier we have 5 billion tablet capacity. And at the peak utilization, we'll be around INR 500 crores revenue from that formulation. Now we have increased it to 10 billion tablet capacity. So the potential for formulation actually is INR 1,000 crores per quarter now, but this quarter, it's been almost only INR 149 crores. So I just want to understand by when you think we'll be able to utilize the increased capacity? We are also even thinking of going to 15 billion tablet capacity. So obviously, we must be having the visibility of utilizing this formulation capacity. So just wanted to understand what is the timeline when we can actually fully utilize this 10 billion tablet capacity?

Satyanarayana Chava: Jeevan, the 10 billion capacity, you can't have just multiply some factors to arrive at the revenue, each tablet can be sold at different prices.

Jeevan Patwa: No, I understand that, sir. I just want to understand the utilization. When can we utilize.

Satyanarayana Chava: By end of this financial year, we expect about 75% utilization of 10 billion units. Still we have some spare capacity. And for us to enhance capacity from 10 billion to 15 billion, we also need

12 months to buy equipment, install, qualify it and validate the product. We need 12 months. So in anticipation of business, after 12 months, we need to start the investment. So we are not investing an additional 5 billion capacity in this financial year. But the building is ready for us to expand capacity from 10 billion to 15 billion will take notice of 12 months if there is an opportunity for us. Otherwise, if you want to make greenfield, you need 24 months' time. So we have shortened that window by 12 months by building civil infrastructure, but not installing the line.

Jeevan Patwa: Secondly, we say that we have almost 47 approved filing in the developed markets with market size of $21 billion. So out of that, how much we have actually launched?

Satyanarayana Chava: We have launched 14 molecules as of now with an addressable market sales of $2.5 billion.

Jeevan Patwa: Next is, I want to understand there has been 50% contribution from CDMO in this particular quarter, but still our margins have actually dropped. So why that has happened? So is it because ARV API has got very low margins or is it something else? Secondly, other expense for this quarter also looks very high. So last quarter, our other expenses was high because of fuel and power cost and also because of the Forex loss. So this quarter, what has happened on the margin front?

Satyanarayana Chava There was a decline in ARV API prices and there is a deleverage in ARV formulations. So our formulation capacity was not well utilized in Q2. So there was a deleverage in our formulations. These two led to the overall decline in EBITDA margins. Otherwise, we could have done better. That is the reason what we have guided for the rest of the financial year, we expect better margin profile because the visibility for ARV formulation is looking bright for Q3 and Q4.

Jeevan Patwa: But our gross margin also declined, sir. So 50% contribution from CDMO, still our gross margin has declined.

Satyanarayana Chava: That's negatively impacted by ARV API as well as formulation price decline.

V. V. Ravi Kumar: You see, our formulation is an integrated play. So if you recollect our guidance on the gross margin side is Our top gross margin is in Synthesis followed by formulation. So when we lose formulation revenue, we not only lose gross margin in the formulation, but also on the API together.

Jeevan Patwa: So in the second half, when you say that we have calibrated and digested our ARV strategy and we also got the orders from the global funds and PEPFAR that is supposed to happen next week. So do you think we'll be able to get to the better margins from here?

Satyanarayana Chava: Better sales will result in better leverage for us, Jeevan. So we expect Q3, Q4, to be better.

Jeevan Patwa: And next is the tax rate. Is it going to change in the second half for us or will it remain the same in this particular way?

V. V. Ravi Kumar: See, conservatively, we are projecting with the old regime. We are evaluating it. There are two, three driving factors. Probably at the end of third quarter or end of fourth quarter, we will have fair idea whether it will be lower side or the same, it will not go beyond this.

Jeevan Patwa: Just one question I think, if Chairman allow.

Satyanarayana Chava: Please go ahead.

Jeevan Patwa: So CapEx in the first half was INR 416 crores, can you just tell us the CapEx in the second half and FY '24?

V. V. Ravi Kumar: Similar number what we are expecting.

Moderator: Thank you. We have our next question from the line of Sudarshan Padmanabhan from JM PMS. Please go ahead.

Sudarshan Padmanabhan: Sir, just to get a little bit more sense on the commentary that you've made and also from the press release, the 70% drop in the Formulation FDF Y-on-Y and Q-on-Q. I mean, specifically, is it primarily led because of higher inventory in the channel or what are the reasons for, number one, the prices being sold not different in the first quarter? And also some color on in terms of if there is inventory, how much is the inventory in the channel? How do we see the margin trend is coming back probably in the second half?

Satyanarayana Chava: We don't expect a lot of inventory in the channel. It's quite visible that our API sales and ARV increase to a normal level. The reason for lower sales of ARV formulations in Q2 - Actually, we saw that impact coming from Q1 itself and significantly lower number in Q2. We didn't adjust the pricing in our tenders. So we lost lot of tenders. But we have calibrated and we are on par with competitive pricing environment. So that's the reason we expect Q3, Q4 to be better.

Sudarshan Padmanabhan: So we would now participate in the forthcoming tender? I mean, at the recalibrated price?

Satyanarayana Chava: Yes, you are right.

Sudarshan Padmanabhan: And what was the kind of extent of pricing drop we have seen between first quarter and the second quarter?

Satyanarayana Chava: Broadly, in the formulation, the price drop was 20% actually.

Sudarshan Padmanabhan: 20% price drop and 50% volume drop in the second quarter over first quarter of this year.

Satyanarayana Chava: I said from the Q2 FY '22 versus Q2 FY '23, the pricing difference is may be closer to 15%, around 15% price drop one time.

Sudarshan Padmanabhan: And sir, on the CDMO side, we've seen a very strong growth in the last three quarters consistently, I mean, can you give some color with respect to the kind of profile of the kind of incremental growth whether it is driven by or is there a revenue concentration in the incremental growth or is it broad-based? How sustainable is the kind of growth that you are seeing on CDMO?

Satyanarayana Chava: We expect to have a good partners, good products. We have good visibility in this segment. We are investing more in capacity expansion in the segment because of the visibility what we have. We are very excited and bullish on this division, not this quarter, in the coming quarters, but in the future years also, we wanted to invest and stay ahead of the curve in offering a sustainable sourcing for CDMO partners.

Sudarshan Padmanabhan: And sir, the revenue growth is broad-based or is it kind of concentrated? I mean, if you can give some color with respect to this.

Satyanarayana Chava: It's broad. It's not concentrated.

Sudarshan Padmanabhan: And finally, on the cost side, as the previous participant pointed out, we seem to have not exactly captured the benefit of higher CDMO, plus also, we are seeing that the transportation costs coming down. If you can give some color for H2 with respect to the second quarter run rate. Costs such as the transportation costs and certain other costs, how they are trending right now? And would we see some kind of a recede in the second half as we go ahead apart from the operating business?

Satyanarayana Chava: The biggest negative contributor to our margin, not significantly decline, some decline was there despite we have done very good in CDMO is because of the pricing pressure in ARV. Otherwise, we could have done exceedingly well. So there is no challenge in the margins of CDMO business. It continues to do very well. But in ARV, there is a decline in margin, that contributed to drag the overall margins for the company.

Moderator: Thank you. We have our next question from the line of Madhav Marda from Fidelity. Please go ahead.

Madhav Marda: I have two questions. First one was, during the initial remarks you've mentioned about some delays on to our revenue target due to change in competitive landscape. Could you please elaborate what exactly is that on? Is that just on the ARV side or was that for something else?

Satyanarayana Chava: Competitive landscape changed significantly in the last 12 months to 18 months in ARVs. In the rest of the businesses, we are seeing good traction, positive traction, actually. So our Oncology business grew, our non-Oncology non-ARV business grew significantly, our non-ARV formulations also we have good progress, good approvals, our CDMO is doing exceedingly well. So, except to the landscape change downwards in ARV, APIs and formulations, rest of the segments are looking very positive.

Madhav Marda: And this level of pricing for the ARVs, the way at least I understand is Laurus is amongst the lowest cost producers for ARVs in the market. So if the pricing is under so much pressure, wouldn't the other competitors be facing a lot of pressure on their profitability as well? So pricing should come back eventually? Is that the way we should think?

Satyanarayana Chava: We hope pricing should bounce back to some extent positively, but I do believe we're at the lowest pricing right now. We don't expect the prices to go down further. So I think any improvement on the pricing side is from positive side only.

Madhav Marda: And my second question was, in your initial remarks, you also mentioned about investing in complex generic products. Could you like elaborate a little bit more in terms of what kind of products such as injectables, inhalors etc, what exactly are we doing here? And also, is it with our own front-end or are we doing contract manufacturing for other pharma companies?

Satyanarayana Chava: I think because of the nature of products what we are working, we don't want to elaborate further on what complex products we are working. But the competition in those products is limited, although they are genericized, the competition is limited. So maybe when we file a product, ANDA, then we will be able to talk more about our strategy.

Madhav Marda: And is there any timeline by when we expect to file the ANDA? Should we say, FY '23 or would it be FY '24? Any broad timeline will be helpful.

Satyanarayana Chava: May be FY '25.

Moderator: Thank you. We have our next question from the line of Krish Mehta from Enam Holdings. Please go ahead.

Krish Mehta: My first question was on the FDF business. If you could just clarify how much of the FDF sales in the first quarter and the second quarter of this financial year was from ARV?

V. V. Ravi Kumar: ARV is INR 55 crores this quarter against INR 275 crores in the previous quarter.

Satyanarayana Chava: So out of INR 150 crores in formulations, only INR 50 crores came from ARVs, the rest came from non-ARVs.

Krish Mehta: And as a percentage of the total revenue, what percentage was ARV versus non-ARV for this quarter?

V. V. Ravi Kumar: There's about 29% is total ARVs.

Krish Mehta: So that's 70-30 now?

V. V. Ravi Kumar: 29%, yeah.

Satyanarayana Chava: Less than 30% contribution came ARVs, both APIs and formulations put together.

Moderator: Thank you. We have our next question from the line of Binu Pathiparambil from InCred Capital. Please go ahead.

Binu Pathiparambil: A couple of questions. One, Dr. Chava, could you please make us understand a little bit about the mechanics of this ARV formulation tenders? Are these like tenders which happen every other day or every other a week for a fixed amount of supply or are these like a longer term supply contract which tranche through months or years?

Satyanarayana Chava: In the Q1 and Q2, the contribution from long-term allocation was less and we didn't have success in getting non-long-term tender quantities, which there was a lot of pricing pressure. But now, the other agencies are about to announce their long-term allocations in this quarter. So, we expect some stability will come in our forecast for the coming quarters. So our lower sales is because we didn't win tenders in the non-long-term focused agencies.

Binu Pathiparambil: So it's basically a mix of both. Broadly put together, I know it's difficult to calculate, but broadly put together, how much of the market would be long-term contracts and how much would be short-term? Is it like roughly 50:50 or?

Satyanarayana Chava: Typically, in the last several quarters, our long-term contract base sales is 3/4th and 1/4th is short-term tender-based. In the last three quarters, the long-term-based tenders awards were less because of the stocking, channel stocking. But now that is done, they are back to ordering stage right now. So that is the reason we expect lot of visibility will come from this quarter onwards.

Binu Pathiparambil: And my second question is regarding FY'24. So when you had this original guidance of INR7,200 crores, generally, we were expecting FY '24 to be a soft or a flat year after a very big growth this year. So now that you have lowered your guidance by 10%, FY '24 still looks like a soft year or are you seeing this last 10% of this year can be caught up next year?

Satyanarayana Chava: We will come back with more updated forecast as we go into Q3, Q4, yes.

Moderator: Thank you. We have our next question from the line of Nitin Agarwal from DAM Capital. Please go ahead.

Nitin Agarwal: Sir, on the ARV business, you had earlier indicated that you would probably be around a run rate of INR3,000 crores per year. Whatever is changing, happening in the landscape, do you think that number needs to be toned down a bit in your assessment?

Satyanarayana Chava: It will be down, but not significantly. If you look at our ARV API is almost INR 790 crores in the past six months. So it's easy, you can expect it to be between INR 1500-1600 crores for the entire year for our API. So our formulation sales is lower in the Q1, Q2, especially very lower in the Q2, but we expect bounce back in Q3, Q4. So, it will be somewhere between INR 2,500 crores and INR 3,000 crores total ARV, API and formulation sales.

Nitin Agarwal: And sir, this is a rate we should assume even on a going forward sustained basis?

Satyanarayana Chava: We expect so. We don't expect growth in this segment We will be probably in that range.

Nitin Agarwal: And sir, secondly on the formulation capacity, you mentioned we have a capacity of 10 billion tablets now. So when you are planning, what was your assessment in terms of how much of this capacity was to be utilized by ARV formulations?

Satyanarayana Chava: Capacity consumed by ARV formulations is less than 20%. See, if you look at tablets-wise, three APIs go into one tablet. So you can't just compare one tablet of ARV into one tablet of Metformin. It is not one-to-one, apple-to-apple comparison. But last year, we produced little over 1 billion tablets in ARV.

Nitin Agarwal: And sir, so you're saying that for the total formulation capacity, ARV will take up only about 20% of your capacity on a going forward basis.

Satyanarayana Chava: Yes. ARV sales, not for us, for anyone, formulation capacity will never go into the bottleneck. Formulation is easier. The challenge is how to make cost effective API is one challenge and winning the tenders is another challenge. Making formulation is never going to be a challenge for anyone, including us.

Nitin Agarwal: And sir, just a point, you mentioned that by the end of the year, you will be at 75% capacity utilization for the formulation business on 10 billion capacity. So, do we see a very significant ramp-up in the non-ARV formulations in the coming quarters?

Satyanarayana Chava: Quantum wise, yes. We are producing non-ARV APIs in a significant volume right now and we expect one more approval by end of this year. With that, we expect to utilize even more capacity in Q4 of this financial year.

Nitin Agarwal: And sir, last question. On the CDMO business, we mentioned in the press release that the purchase order which you've got is sort of getting executed also steadily in the current quarters, but how should we look at the purchase order business, sir? Is it only for this year or it has continuity beyond current year also?

Satyanarayana Chava: We have visibility for this financial year, but we don't have visibility for next financial year for the purchase order. But we have a lot of projects under the evaluation, under execution, under negotiation, so this division, rest assured, we are focusing and investing significantly into this.

Nitin Agarwal: And sir, just last question on this. Given the very high base that we will create in CDMO this year, is it fair to expect a flat to a growth number next year on this date or given the very high base this year, that would be difficult?

Satyanarayana Chava: We'll come back with more specific details. It's too early for us to comment on the FY '24, CDMO numbers right now.

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

Tushar Manudhane: Sir, given the kind of disruption that has already happened on the pricing on the ARV front, even if you win the contracts, what gives us confidence that we'll be able to do 30% margin because the ask rate for second half FY '23 would be 32% plus of the margin, to achieve 30% margin for FY '23?

Satyanarayana Chava: For the first half of the financial year, we are already at 29% EBITDA margin. So when we are saying we will maintain about 30% EBITDA margins, doesn't mean we are saying 30.00%. We have to improve beyond 29% to go closer to 30%, which we are very confident. As we mentioned to some of the investors in this call earlier, because of the deleverage happened in formulations, that was compensated by higher margin Synthesis deal, otherwise, we could have done better.

Tushar Manudhane: And in fact, even in the sales run rate of the non-ARV formulation has been relatively lesser for the quarter. Any particular reason to highlight?

Satyanarayana Chava: Actually, it was very good. Non-ARV doing INR100 crores per quarter was good. And our non-ARV quantum-wise will grow in Q3, Q4. As we mentioned, our sales to European partner will happen in Q3 and we are shipping in this year for this quarter and next quarter. We have a very good visibility there.

Moderator: Thank you. We have our next question from the line of Kunal Dhamesha from Macquarie Capital. Please go ahead.

Kunal Dhamesha: One basic question on the CDMO business. So right now, when there is a new RFP that has been floated, have you seen any change in the trend of new RFPs being floated, given the biotech has been under lot of pressure on the US side?

Satyanarayana Chava: We haven't seen any decline in the number of RFPs being floated by our partners from Q1, Q2 to current quarters. Actually, maybe trend is positive rather than negative in the number of RFPs.

Kunal Dhamesha: And a number of people bidding for particular RFP, have you seen any change in trend over the last couple of quarters

Satyanarayana Chava: We don't have visibility on that. We can't comment on how many people receiving same RFP. We have no visibility on that.

Kunal Dhamesha: And one question on the ARV business. When we say that short-term contracts, the pricing has gone down, but the long-term contract, allocation is about to happen. But does the short-term contract pricing are like a bellwether for the long-term contract pricing or the pricing could be different for the long-term contracts?

Satyanarayana Chava: Long-term contracts are generally better than the winner-takes-all tenders. But eventually, one could expect that lower pricing will also have an impact on the long-term pricing again.

Kunal Dhamesha: And is it possible with short-term contract winner-takes-it-all kind of situation versus long-term contract would be like a much more stable allocation we're doing the major players?

Satyanarayana Chava: In long-term contracts, there are allocations they do and nobody gets more than 1/3.

Kunal Dhamesha: And in short-term, it's not the case?

Satyanarayana Chava: This is not the case. We have some cases people get 50%, some cases picking at 100%.

Moderator: Thank you. We have our next question from the line of Palak Shah from Infina Finance.

Palak Shah: Sir, firstly, I just wanted to understand, so our FY '23 growth has two big components to it. First is your CDMO business doing phenomenally better, because of the large purchase order and now we're looking at a price erosion in ARV, API and formulation business both. So on that base, FY '24 growth seems to be a bit difficult or do we have more levers which can actually aid us to grow next year?

Satyanarayana Chava: We are creating a lot of capacity. We have the levers to grow, but we will give you more color and updates as we come closer to the financial year.

Palak Shah: Secondly, you have revisited our guidance of $1 billion target at INR 7,200 crores, but now given that currency depreciated and we have rationalized our guidance by 10%, but effectively a 20%, 25% cut in the rupee term that you would have expected. So is the understanding right?

Satyanarayana Chava: You are absolutely right. See, as we gave numbers in our presentation, our decline in formulations in the past six months is almost INR 500 crores. So that means we are not going to recoup in the next six months. So that led to revising our guidance lower to our aspiration number of INR 7,200 crores.

Palak Shah: So just lastly if you could permit me for this. Given the price increase, price decrease have happened across ARV formulation and API and we still intend to maintain our margins. Can you explain a bit, which will help us maintain the margin, because my understanding would be price erosion would lead to some dilution of margin as well?

Satyanarayana Chava: So if you look at our contribution coming from ARV APIs and formulations will remain flattish. Whereas rest of the businesses are growing significantly. So even though there is a price pressure on ARV, because of flattish base for that and the rest of the businesses are growing, which are more favorable in margins that is the reason we expect the margin profile will remain same or better.

Moderator: We have our next question from the line of Bharath from Quest for Value Capital. Please go ahead.

Bharath: Last quarter, there was an increase of other expense by INR 70 crores and the reason mentioned that time was, due to a one-time cost of power, fuel and Forex loss and this is one-time. And even in this quarter, we see that the increase of INR 70 crores in other expenses. May I know the reason for this?

V. V. Ravi Kumar: I think Forex loss even in the second quarter is also there, though it is unrealized. And of course, power and fuel, it got restored. The additional expenditure in the power and fuel what we have spent in quarter one is not figured in quarter two.

Bharath: Yeah, but then it should reduce, right? The other expense will reduce, but it's still at the elevated level.

V. V. Ravi Kumar: There are some other expenditure also there. We are adding new blocks and new capacity added for formulation. For that, we have to recruit more people, etc and more operating expenses also to be incurred for those.

Bharath: And in the Board meeting today you approved for incorporation of new specialty chemical business. May I know what is this business?

Satyanarayana Chava: This is an adjacency to what we are doing. We intend to make some chemicals to start with what we consume, which we are buying from third parties. So we will make some very large volume, medium volume and small volume products. So these specialty chemical prices vary from $1 to $100 per kg.

Bharath: And in last con call, you said that generally for these tenders, 10% of the tenders are like winner-takes-all and rest 90% is something like evenly spread. It's like 30% to the first guy, and 20% to the second guy and 30% to the third guy, something like that. So now and you said that now we lost most of the tenders, does it mean that we have not even won any of those tenders where it is evenly spread?

Satyanarayana Chava: We haven't won significant numbers of winner-takes-all, we didn't win much. That was quite visible for our lower sales in Q1 and significantly lower sales in Q2 was because of that.

Bharath: So you mean to tell us in Q2 also most of the tenders were like winner-takes-all, am I right?

Satyanarayana Chava: Yes.

Bharath: So this 10% of the tenders are mostly in Q1 and Q2?

Satyanarayana Chava: Yes.

Bharath: And my other question is like, till recently, we had this 5 billion capacity for tablet and I understand that out of which 2 billion is utilized for ARV and 3 billion is for non-ARV. And I assume that this complete 3 billion is fully utilized, am I right?

Satyanarayana Chava: Our old formulation block is optimum utilized. And even in the new formulation block, about 1 billion units we are producing on average basis right now out of 5 billion new capacity, which we expect to utilize another 1 billion units on an annualized basis by end of this financial year. That's what I said. By the end of this financial year, about 50% of our new 5 billion capacity will be utilized.

Bharath: And the old 5 billion.

Satyanarayana Chava: Optimum, it's maxed already.

Bharath: So does it mean that out of this old 5 billion capacity, so 3 billion is for non-ARV, right?

Satyanarayana Chava: Broadly, yes.

Bharath: Broadly. And this quarter we have done INR 100 crores of revenue from these non-ARV. So does it mean that out of this 3 billion, we were able to generate a revenue of INR 100 crores for non-ARV. Is my understanding right?

Satyanarayana Chava: You can't slice that way and then multiply. But broadly, you're right. We have been about 1.3 billion, 1.4 billion units contract manufacture into one partner. And we are doing another 1 billion for our own formulations for Canada, US and other markets. You are right broadly, yeah.

Bharath: And my last question is like this 2 billion tablet capacity which we have on ARV, is that fungible. Why I'm asking like if you want to shift it to non-ARV, is it possible.

Satyanarayana Chava: It's very fungible. And as I mentioned, making ARV, for this if there is opportunity for 3 billion ARV, we can do 3 billion. So like ARV formulations are fungible, non-ARV capacity is also fungible to ARV.

Moderator: Thank you. We have our next question from the line of Gaurav Singhal from Aspex Management (HK) Limited. Please go ahead.

Gaurav Singhal: I just wanted to follow-up on some of the questions that have already been asked. You mentioned that by the time we exit this financial year, our formulation capacity, we would be able to exit at like 75% kind of utilization for the 10 billion capacity. Can you share what our utilization was in 1Q and 2Q?

Satyanarayana Chava: It was less in Q2, very visible of our lower sales.

Gaurav Singhal: But if you want to share a number, if that's possible for 2Q or 1Q?

Satyanarayana Chava: We can't share more granular than this. We're sharing a very detailed number. But if you want, maybe you can reach out to Vivek and he will be able to have a discussion offline.

V. V. Ravi Kumar: I think it's been very fungible capacity. It is very difficult to explain like that.

Gaurav Singhal: And then for the ARV long-term tenders, pardon me, this has been discussed in earlier calls. But how long are these long-term tenders that shall we expect?

Satyanarayana Chava: Long-term awards typically for three years. We allocate certain percentage of their purchases, that's for three years.

Gaurav Singhal: And then when global fund, which is expected to announce the long-term award, they are expected to announce allocations next week. So this is something that, if I understand correctly, we already have won these orders and it's just like a public announcement would be made next quarter or does the company also not know right now and they will also find it next week? I'm not sure if I understood that correctly?

Satyanarayana Chava: We don't know the results yet. So they haven't announced.

Gaurav Singhal: So global fund will know the results next week and PEPFAR will know some time into December?

Satyanarayana Chava: Sure.

Moderator: Thank you. We'll take our last question from the line of Neha Agarwal from SageOne Invest. Please go ahead.

Neha Agarwal: Sir, my question is largely on the non-ARV formulations side. If you could give more guidance on the growth visibility there pertaining to launches that we have made so far? And also, I think end of FY '22, you mentioned opportunities in the gliptins and sartans segment because of the kind of superior purity of the product that we have, shows better quality that we have and we'll be able to garner better market share? What is the progress there?

Satyanarayana Chava: So when you compare our formulation sales in Q4 last financial year, we did about INR 500 crores, which has de-grown, to INR 150 crores. So there is a room for us to go back to INR 500 crores. The growth will happen from ARV and non-ARV both. But maybe by end of FY '24, most of the growth in the formulations will come from non-ARV. Like our API growth is coming from non-ARV APIs, by end of '24, most of the growth in formulations also will come from non-ARV. In ARVs, there is a limit for us to grow in both APIs and formulations. We believe by end of next year will reach the plateau. And then growth will come from non-ARV in formulations too.

Neha Agarwal: Totally, In particular to non-ARV only. My question was, how is the product launch -- I mean, the product that we have launched so far, how is the growth coming along in those? In terms of market share, I mean.

Satyanarayana Chava: We are launching two products in Europe this quarter onwards. And we expect one product will be launched in US Q4 this financial year. So those products, plus Europe products already we started shipping. And US, depending on the approval we expect, the approval was delayed by a quarter. So that launch will happen early next year, calendar year. All these new products what we are talking is non-ARVs.

Neha Agarwal: And any overall revenue guidance on the non-ARV formulation front for the full year?

Satyanarayana Chava: We can't give you more granular than this. I'm sorry for that.

Neha Agarwal: And if you could just help me with last year's non-ARV formulations number, please?

V. V. Ravi Kumar: It's around INR 250 crores or so.

Neha Agarwal: Around INR 250 crores was non-ARV?

V. V. Ravi Kumar: Yeah, correct.

Neha Agarwal: And definitely on that base of non-ARV and just leaving aside the ARV formulation piece, at least we can expect a good strong double-digit growth on that?

Satyanarayana Chava: You're right.

Neha Agarwal: But overall with just one last question. With the kind of pace that we are seeing in terms of formulations launches on the generic formulation side, do you think we could see a kind of similar to what we have in CDMO in terms of growth for non-ARV formulations also, a similar growth aspect?

Satyanarayana Chava: Formulations, we expect a lot of growth will come in FY '25 not in '24.

Neha Agarwal: And just one last question on the multi-year contract that you had and which you signed earlier this year. So revenue have started coming from there already?

Satyanarayana Chava: No. The new site for that will be qualified next year.

Neha Agarwal: So I think second half of FY '24 and then more meaningfully in FY '25, would that be correct?

Satyanarayana Chava: Yes.

Moderator: I would now like to hand the conference over to Dr. Satyanarayana Chava for closing comments. Over to you, sir.

Satyanarayana Chava: Thank you, Monish for organizing this call. Thank you participants for asking very interesting questions. And we wish you happy and safe Diwali. Thank you.

V. V. Ravi Kumar: Thank you.

Moderator: Thank you, sir. On behalf of Antique Stock Broking, that concludes this conference. Thank you for joining us. And you may now disconnect your lines.