"Neuland Laboratories Limited's Q1 FY22 Earnings Conference Call"

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Diwakar Pingle: Good evening friends. Good morning, depending on which geography you are from. We welcome you to the Q1 FY22 earnings call of Neuland Laboratories Limited. To take us through the results and answer your questions, we have with us the top management from Neuland, represented by Mr. Sucheth Davuluri – Vice Chairman and CEO; Mr. Saharsh Davuluri – Vice Chairman and Managing Director; Mr. Deepak Gupta – CFO and Mr. Sajeev Emmanuel Medikonda, Head, Corporate Planning and Strategy.

We have sent out the press release as well as the detailed presentation and the same have been uploaded on the website as well as the exchanges. You could take a look at that or in case anyone of you wants it, we could e-mail the same to you.

Before we start, I would like to remind you that everything that is being said on this call which reflects any outlook for the future or which can be construed as a forward-looking statement must be viewed in conjunction to the risks and uncertainties that we face. These uncertainties and risks are included but not limited to what we have mentioned in the prospectus and in the subsequent annual reports which you will find on the website. With that said, I will now hand over the floor to Deepak Gupta the CFO, who will give financial highlights of the quarter and after that Saharsh will talk a little bit about the business drivers and outlook, and then we will throw it open to the Q&A. Deepak, over to you.

Deepak Gupta: Good Evening and very warm welcome to our Q1 FY22 earnings call. I hope all of you are here are healthy and safe. I am sure that you have seen the presentation which Diwakar was mentioning. It was put upon our website and also been filed with both the exchanges. As always, any comments on the content presented would be greatly appreciated, and we will do our best to give if you need any additional data points in the future.

I will briefly update you on the financials, total income for this quarter was Rs. 202.9 crores as against Rs. 206.1 crores in Q1 FY21. So we had an unusual business complexity combined with slight customer inventory destocking which led to flattish turnover. Our EBITDA for the quarter was Rs.27.7 crores with EBITDA margin of 13.6%, which is a decrease of 310 bps points on a yearly basis and 180 bps point on a sequential basis. I would like to give some context on the EBITDA margins, there was an impact on rising raw material prices, we also incurred certain upfront costs on account of certain projects which we have been working on. The execution has been slightly delayed on account of the complex nature of these projects and delivery is also expected to happen in the subsequent quarters.

PAT was Rs. 8.6 crores, as compared to Rs. 15.1 crores last year and Rs. 17.2 crores in the immediately preceding quarter due to reasons stated as above. This quarter EPS is at Rs.6.7 and cash and cash equivalents as on the date of the balance sheet stood at Rs. 24.5 crores. Our gearing ratio continues to be stable, and it is low at 0.22x on a year to year basis. We have also undertaken capex investments of around Rs. 29.8 crores for Q1 FY22. We have a strong business plan in place for which we do expect to make significant capex investments, based on the commercialization and scale up of CMS initiatives going forward. With that I would now like to hand over the call to Saharsh for his remarks.

Saharsh Davuluri: Thanks, Deepak. Good evening friends. First of all, thank you for joining this call. On top of what Deepak has just said, I will add a few thoughts on the current performance, and then we will open up the floor for Q&A.

Just to take a few minutes to just help you understand that the numbers itself for the first quarter are disappointing, but I would like to reiterate that our confidence in the business, both from a medium and long term perspective is still very strong. Deepak has touched upon the factors that contributed to the drop in the topline, one of those key factors was the delay in execution of certain CMS projects.

You may recall that we have quite a few exciting CMS projects in our pipeline we talked about it with the previous quarters. Many of these projects are one or two steps away from commercialization, which is when we really start seeing a continuous commercial revenue. These projects typically involve complex chemistry and are being scaled up for the first time in our plants. One of the things that we have had to endure, is to ensure that first time right happens, our ability to make sure that these processes work right in the plant. We are being extra careful and in that process we are seeing some extension of timelines, which is what is causing some of these projects to get spilled over into the subsequent quarters. During this process we have been very closely collaborating with our customers and anticipate scaling up these projects in the coming quarters. Therefore, we expect overall performance of the current financial year to be still on track. More importantly, we are also excited about the prospects of these molecules, once they become commercial.

On the financial front we recorded sales of Rs. 203 crores, as Deepak had stated in his comments the sales were almost constant on a yearly basis. Also on the basis of a few customers doing inventory destocking amidst the pandemic. However we expect this to be a temporary phenomenon as we receive continued interest across the board from our customers.

The Prime segment witnessed growth, largely led by Labetalol, Levofloxacin. The specialty segment saw volatility on a high base. However, both Ezetimibe and Entacapone has done significantly well. On the unit III front I am sure you would like to know I am happy to say that we have started commercial supply of API's from this unit. All incremental revenues for Neuland will accrue from this unit going forward, as both unit I and unit II are already running at optimum capacity. And we are looking at significant ramp in terms of capacity utilization of unit III in the medium term, as well and this should drive our future growth. Before I close my remarks I just like to reiterate that the nature of CMS projects means that revenues does get lumpy and which consequently affecting our EBITDA margins. However, this quarter we have seen that, although there was a strong raw material price increase, the business mix especially in terms of our CMS project spends meant that we saw better gross margins. So this is maybe one kind of silver lining to the cloud. The overall outlook for this year as well as the medium term, outlook for next 3 years looks good and we are focusing our efforts on delivering value to shareholders. Having said that, I request Diwakar, now to open the call for Q&A.

Diwakar Pingle: Thank you Saharsh. So the first question is from Mr. Sunil Kothari. Request you to go ahead.

Sunil Kothari: Thanks for this call and on webinar, it looks really great to hear and see you. Sir, basically my question is you being a listed company we normally as an investor what we do, we compare yourselves with other listed companies in similar type of groups and our understanding is always limited to outcome of your effort, which is always numbers. So, it is becoming little difficult to understand and digest that we are not able to do some, in terms of revenue growth, in terms of margin, in terms of ramping up, in terms of unit III not yet able to ramp up. All these things are giving little question mark on our understanding and your explanation, so if you would like to talk a little bit more in detail why things are not happening. Fine it takes time sometimes but, unfortunately if we compare this quarter to last year same quarter, we are almost spending Rs. 9 crores on higher employee costs, Rs. 10 crores on higher manufacturing costs. So, I understand that because of unit III or higher manpower and all these things the margin is under pressure, but we have some listed other entity in your field which is growing, investing more, spending more, generating more revenue and increasing margin. So little bit explanation on our understanding and your business profile will be really helpful. Thanks a lot.

Saharsh Davuluri: Thanks for the questions. We try to answer it to the best as we can, I will try to give it a first stab and then maybe request the Sucheth and Deepak also to respond. As you could know we are a pure play API company, we have a focus in the CMS space which is broadly known as the CRAMS space and we also are in generic API space. What makes our business, both exciting as well as difficult to predict, is the fact that we have a lot of products in the pipeline which are yet to be scaled up and as we are going through the journey of scaling up these products, we also have the added complexity of using new infrastructure which is the unit III, our manufacturing site and integrating it and using it for scaling up these new products. As we are going through this journey, we have seen in the past that as the products get scaled up and they start contributing we will see better operating leverage contributing to increase in EBITDA margins, and profitability. However given the fact that some of these products have not fully been commercialized and there is still some uncertainty involved in their scale ups etc. as we have seen this quarter. The absence of revenue coming from some of these molecules can also create a negative pressure on the EBITDA margin and at the PBT level. Therefore, what gives us a lot of optimism is that these molecules are very exciting both on the GDS side and on the CMS side, we see good prospects going forward with these molecules, but there is also a certain level of lumpiness that comes with these molecules because their progression towards commercialization is not going to be a very straight line. Having said that, we find it very difficult and we have not very extensively benchmarked or compared ourselves to other API players because we believe that our model is unique that way. We have mentioned in the past that, on an ongoing basis we expect our EBITDA margins, we have said this in the past to be at 20%, but that's something that we have not shared as guidance, we have given it more as in terms of what it would be as our business gets commercial. This is something that we feel is an intrinsic part of our business, but as we go forward as I did mention in the opening remarks, we see very strong prospects for all our molecules, both on the CMS side and the GDS side. This was a quarter where we just had challenges in execution and therefore, the performance of this quarter should be seen more as an outlier, rather than as an expectation going forward. So that's kind of what I would say.

Sunil Kothari: Yeah, sir so basically, what I would like to understand is the any specific reason for this unit III is taking too much longer time or it is as per your plan and execution and last point is, if we look at other than CMS that segment is also this prime and specialty segment that is also not going. So, any thoughts on these 2 segments which is contributing almost 75-78% towards revenue. So on these two points if you clarify more.

Sucheth Davuluri: So, as far as Unit III is concerned, currently there are two things that are happening. One is that we are moving our existing commercial products to unit III where the volumes are increasing or we are actually creating a backup plan for existing commercial products so that once we move that product, it creates more volume and more capacity for products manufacturing in the older units, that's one particular strategy. Apart from that all our new projects are also being manufactured in the unit III. So unit III, as Saharsh mentioned earlier on this calls is where lot of the growth is going to come from. Coming back to something that Saharsh said if you look at the trend of our numbers for the last three years, all the segments have growing, whether it is prime, whether it is specialty as well as the contract manufacturing. Even in the previous calls also, we mentioned that given the nature of our business, given the size of our projects, we do expect that there will be a quarter to quarter lumpiness and that doesn't necessarily reflect the overall business, or the overall expected performance, we continue to maintain the same given the kind of business we are in, and the contract manufacturing is a huge opportunity and we are still in the process of consolidating that business. We will see this quarter to quarter lumpiness, but as Saharsh said in his previous comments, this quarter was a little bit of a stretch. Unfortunately the timelines of our customers and the projects don't always coincide with the timelines of a financial quarter, so there could be variation and that does not determine or take away from the overall expectation of performance.

Sunil Kothari: Thanks a lot and just if you can clarify this unit III by when you expect, giving us some reasonable contribution, sizable contribution this is my last point. Thanks a lot.

Sucheth Davuluri: This current financial year, we will see reasonable contribution because we are already shipping commercially from unit III. We expect those volumes to go up in the current quarter, as well as the next two quarters.

Diwakar Pingle: Thank you Mr Sunil Kothari. The next question comes from the line of Srinivas Rao.

Srinivas Rao: Sir, just know you said in the introduction that, the year as a whole, you are still on track. Could you please explain in more detail what is on track, whether top line and bottom line, what could be it, whether it is 20% yoy or 30% yoy.

Saharsh Davuluri: Yeah, I think the question was clear. Basically, what we meant, is that whatever shortfalls we faced in the first quarter that shortfall happened because of certain projects getting delayed and those projects have actually shifted or spilled over into the second quarter and little bit into the third quarter. So, overall plans for the financial year remaining intact, which is what we implied in the opening remark.

Srinivas Rao: Sir, I understand your point. Overall, for the full year it remains intact. Then, can you please explain what is intact, like whether it is 20% growth or 30% growth. What could be the target revenues for the year because if you see last quarter also there were some aberrations and we are not getting a clear picture from the management as to what is the near and foreseeable future as far as financial performance of the company would be.

Saharsh Davuluri: Thanks for the question and I try to clarify to the best that I can. We obviously won't be able to give you a very specific answer on what we will be the growth rate for a year. What we have said in the past is that, as an organization we are targeting anywhere around 15% yoy growth over the long-term perspective. We also said that our EBITDA margins should be at about 20%, on an ongoing basis. Those are two comments that we made in the past and I think that's the extent to which we will provide any kind of visibility. However, we also mentioned and qualified saying that given the nature of our business we expect to see volatility, not just at a quarter to quarter level but even sometimes on a year to year level, where we may not see a uniform growth on a year to year basis. Having said these two things, what we have also mentioned, is that a lot of our business growth is coming from the scaling up of new products. And those new products are actually going through scale ups right now and unit III plays a very important role over there. What we expect in FY22 is that whatever challenges we have you seen within the quarter are things that we expect to surmount over the next several months over the next few quarters, and therefore, we expect our FY22 performance to be intact. That performance is in line with our earlier comments, which is on an annualized basis we should see a 15% growth but at the same time, I would like to caution you that what we are saying is not a year on your guidance. So we are not indicating to you that we will grow 15% every year. But you should expect that on a five-year horizon, you should see the company growing at 15-20%, on an average. So I think that's the kind of clarity we would be able to provide, not because we do not wish to share more details, but it's just the uncertainty of the business that we are in, we would be finding it very difficult to provide more granularity beyond this point.

Srinivas Rao: Sir, I appreciate you being cautious on your guidance. But sir, how your pharma company is different from other pharma companies because you feel there are more uncertainties than other pharma companies, at least in the foreseeable future. And my next question would by which timeframe you can expect it 20% EBITDA.

Saharsh Davuluri: So, let me give quick answers in the interest of time. Obviously, we understand our business really well and we are happy to talk about the drivers for our business but we cannot talk or compare ourselves extensively with other pharmaceutical companies in what they are doing. The growth factors for our business is really what's happening on the CMS business. I think, for the GDS our growth in prime, which is something that we have been seeing, we talked about the growth in Levofloxacin as well as Labetalol. We have also talked about at Entacapone as well as another product on the specialty sector and these are what are driving our growth. With regards to the EBITDA margins, we have seen our EBITDA margins consistently improve. I think, even in the last financial year, we have seen an EBITDA margin at about 18%, which has been a substantial improvement over the past, we expect our EBITDA margins going forward, also to grow and that's largely going to happen because of the improvement in the operating leverage of the business. This particular quarter was an aberration, we could not see the operating leverage because there was a dip in revenues, and therefore consequently, there was a dip in EBITDA. I think over the subsequent quarters, as we see our business resuming to normal levels, we should see an EBITDA margin getting back to a higher level, although we would not comment on very specifically, we would get to 20% EBITDA. So that's as much clarity we can provide at this point of time.

Diwakar Pingle: The next question comes to the line of Rahul Bharadwaj. Rahul go ahead.

Rahul Bharadwaj: So I have two quick questions. One, I would like to know, what is the opportunity that Neuland as a company is most excited about in the next five years that they can share with us. And secondly, since due the client requirements, some of the revenue could not come in this quarter as they had been delayed. Can you provide us some guidance into if we can expect a 20% plus growth for Q2 in terms of the deferred revenue. So those are the two questions from my side.

Saharsh Davuluri: From a long term 5 years perspective, there are several molecules in our CMS pipeline. I think every quarter we been sharing a table that shows how many molecules we have across phase 1, phase 2, phase 3 and commercialization. There is a column in that table called development and there is a column called commercialization, if you actually see the molecules that are transitioning from development to commercialization, I think that is where is the maximum excitement, because many of these drugs, many of these API's are going into novel drugs that have been recently launched or are going to be launched in markets like Europe and the US. And depending on how successful these drugs could be, they could be very big revenue drivers for Neuland. So, that is something that excites us a lot. Because of the confidential nature of these molecules, we cannot disclose the identity or the nature of these particular API's, but we have at least about 4 to 5 molecules which are in this category and we hope that at least, maybe a few of them will be really successful. So that's something that really excites us. In terms of other product drivers, on the GDS side we have a very exciting basket of products, we have products which we had in our portfolio for quite some time but are continuing to grow now products like Levetiracetam. We have products, which are also niche nature from our specialty category, which are all going for scale up and commercialization in the years to come. And those are things that really could be exciting revenue drivers for us. With regards to the guidance of the spillover, I think that's something that we would not be able to share. Like I had mentioned in the comment earlier, I think we are on an ongoing basis targeting a 15% kind of revenue growth. It's not necessarily that is going to happen every year. It's also because there is going to be certain unknowns in what's going to happen in the next three financial quarters. So we would expect to have a good financial year. We don't expect Q1 to have a impact on the rest of the financial year but in terms of what we would do and how much we grow, that's something that we won't be able to comment on. Sucheth you want to add anything in terms of what's exciting in next 5 years.

Sucheth Davuluri: Rahul going back to your question, it is exactly what Saharsh has said. See, at the end of the day how successful a molecule is going to be on the contract manufacturing side especially, is something we cannot disclose, the NDA can get approved and it may still not mean anything. So we are not in the business of making molecules successful that entirely depends on the uses of molecule. However, what's in our control is the number of projects that we acquire from our customers and the number of projects that we are able to execute. And if you look at the trend of the molecules over the quarter that has been constantly increasing. The number of projects we execute, the number of molecules that we develop which are a phase 1, phase 2 or phase 3 clinical trials having been constantly increasing, which means that the probability of success with these molecules is increasingly going up every quarter, and for us that's what's exciting because that is something we can control and the more projects we get the higher probability of success for the higher number of molecules and single mindedly that's what we are excited about from a contract manufacturing point. From a generic point of view, our strategy as has been mentioned on this call earlier, is very clear, we don't like to do or develop every molecule under the sun. We are very clear about the kind of molecules we want to go after this includes novel or oral anticoagulants which are exciting opportunities. Our goal is once we launch them, we stay with the molecule, we invest in lifecycle management, we invest in capacity and eventually over a period of time we do end up becoming the market leaders in our generic molecules. And we are able to protect the margins, and the name of the game on the genetic side is obviously persistence, staying with the molecule and investing in that molecule to protect margins. So that's Neuland's business model as well as our excitement in nutshell as Saharsh articulated as well.

Diwakar Pingle: Thank you Sucheth and Saharsh. The next question is from the line of Sahil Sharma. Sahil I have opened up your line please go ahead.

Sahil Sharma: First of all, I am Sahil an individual investor, really appreciate your move through these conferences on Zoom, I think it's a great step in adopting digitization and technology. So the first question I wanted to ask is if you look at the past few presentations, consistently we see that we have filed 898 Plus DMF, we have 300 process patents. What I am wondering is these numbers have not really moved in the presentations. So basically what's happening on the R&D side for generic molecules, and like, why don't we see more DMF filings, or process patients. That's my first question.

Saharsh Davuluri: Thanks Sahil. I think it's a good question. I think with regards to DMF filings your observation is absolutely right. I think there hasn't been a movement, in the last quarter or two. But that's also because of the timing of how the projects have been going through and I think given what we have seen recently we expect to have a significant number of filings in the next two, three quarters. Our target internally is, about 6 to 8 DMF filings, in the next three quarters whether we will be able to make them happen or not is something we will have to see, but there was a period of lull. With regards to process patents, we have to get back to you on that I think process patents is something that we continuously file, but those are also something that happens based on our ability to generate novel drugs. As an organization we don't have targets, we don't say targets to our scientists are to file patents, I think whenever they come across something novel that's when they file it, but I think DMF is something that we actively track, but again, going back to the comments which Sucheth was making to the earlier question. The focus is becoming more in terms of the quality of the products and the number of DMFs filed but having said that, we still expect to file 6 to 8 DMFs in this financial year.

Sahil Sharma: Just a small clarifying question when you say six to eight DMF you mean US DMF or all across the globe.

Saharsh Davuluri: US DMF and they could possibly also translate into CEPs, other EUDMF or other DMF.

Sahil Sharma: Thank you so much. So that's all I have.

Diwakar Pingle: The next question is from the line of Karan Surana. Please go ahead.

Karan Surana: Thank you for giving me this opportunity. So I have a couple of questions. So, as you mentioned that there was a steep increase in raw material prices, so just like some colors from the management, what led to this, from what geography did the price increase come from because in the previous concall we have stipulated we are going to de-risk our supply chain from China. That's number one and number two, we would like to ask you as well that the CMS revenue from the last three quarters have been dropping sequentially. It did around Rs. 90 crores, then Rs. 60 crores and now Rs. 44 crores and even though, you talk about like the projects that's what we are kind of focusing on. You did not do any new projects in the development or the commercial side. So, are we essentially getting lower value per project, or what exactly in that particular space the company kind of looks at per project to do, any color on that.

Deepak Gupta: Thanks, Karan for asking that question. So, in terms of raw material prices we have seen that in this quarter due to COVID, the solvent prices have spiked, so raw material prices for solvent has spiked not only for Neuland but across the industry. So that has some marginal impact on our bottom and we will see that slowly these solvent prices will come back to the normal price range. So we have seen a couple of solvents, which have really hit our EBITDA margins in this quarter and we are seeing that trend is declining and going forward, that will ease out the pressure on margins that we have seen. So that's where we stand as of now.

Saharsh Davuluri: Maybe I think for the other question, which is about the sequential dip in revenues and on the CMS revenue dip as well, I think your observations absolutely right. From our perspective, the CMS order book as well as the potential value of the business, as well as the overall value of your business I think everything is looking fairly strong today. It's more about our execution and deliveries which has really kind of created that optics that there is a sequential decline. If we had not had those execution delays in the last month, maybe you would have seen significant growth in both Q1 revenues as well as CMS revenues, although we are not really able to quantify them. So I think the observation boils down to the same underlying issue which is the delay in executing some of these CMS projects is what's really kind of creating that optics of sequential dip in revenue, but we are also fairly confident that will be overcome in the subsequent quarters because we have a clear handle on handling these challenges. That's kind of what I would add.

Diwakar Pingle: The next question comes from line of Jyotivardhan Jaipuria from Valentis Advisors. Please go ahead.

Jyotivardhan Jaipuria: So just going back to this dip in EBITDA margin which we saw, I guess there's like a 350 basis points dip from the last quarter, sequential quarter. So, we have said it's because of two factors one is higher raw material prices and the other is upfront expenses on some projects. Now like the way I calculate it our gross margin has not really changed so it's all below gross margin so that way raw materials have not had a main impact, the impact is something else. So what are these other expenses incurred for some projects, and where are they reflected.

Deepak Gupta: So, in terms of EBITDA margin as we said, raw material prices have marginal impact on the EBITDA margin. Apart from that, unit III, earlier it was not operational last year, last quarter. So now since we have commercialized unit III, so ramping up of unit III is also happening in this quarter, so we have seen that we have added some people for unit III this quarter as compared to the last year quarter. So that's also kind of adding short term impact on our EBITDA margin but once you see revenues coming out of Unit III that will be very positive on our EBITDA margin going forward.

Saharsh Davuluri: So the reason why the gross margins have improved is because of a better product mix, while it could have been higher if it wasn't for the raw material prices I think the fact that we had CMS products with a healthy margins in Q1FY22 the overall gross margins will look very good but the fact is that there were still challenges because of the solvent prices that we have.

Jyotivardhan Jaipuria: I guess we knew, even earlier that we are going to start unit III, right. So to that extent like two months ago or three months ago when we did the earlier call we knew this. So what really has changed, because I guess three months ago we didn't expect anything like this, right, in this quarter.

Saharsh Davuluri: So I think if you look at dip in EBITDA for the quarter I think it's a combination of multiple issues, like the capitalization of unit III which was foreseeable is something that is true but what was not foreseeable is the dip in revenue that came because of the delay in execution of projects. Hypothetically speaking, if we were able to execute our plans in Q1FY22, which is even if we were able to deliver the projects we were supposed to deliver in Q1FY22, then despite the increase of operating expenses due to the capitalization of unit III, despite the increase in raw materials we should have been still being posting good quarter optically from year on year basis or quarter or quarter basis. So I think it's a problem that has manifested because of two-three factors rather than one factor. So it's something that, in hindsight whether it could have been predicted or not is something that we are not very sure about.

Jyotivardhan Jaipuria: So, probably I guess a lot of earlier participants have asked this. So, when we are saying now for the full year we think all of this will even out and we will end up with a good FY22. Can you spell out what is a good FY22 will be. Will FY22 grow over FY21 or will a dip over the FY22 over FY21 in EBITDA and sales and even that would qualify as a good FY22. Mean can we get some like I don't want to know whether we got 15%, or 18%. But if we let's say have a flat FY22 versus FY21 would that be good or would that be not so good.

Saharsh Davuluri: You know, our FY22 should be better than what we did in FY21. But yeah, I think we will not quantify it, but it should be a better year in revenue as well as EBITDA terms. And I think the only limited point I did want to emphasize is that whatever hit we have had in Q1 would be delivered in the subsequent quarters. So on net net terms we don't see any impact for FY22.

Diwakar Pingle: I will now allow Keval Ashar to go ahead and ask his question, Please go ahead.

Keval Ashar: I had only one question so we have seen in our product pipeline Semaglutide is there. So wanted to know what is the size of potential that we are seeing in Semaglutide. Considering that Glucagon like peptides have shown a good growth over the past few years.

Saharsh Davuluri: So GLP ones are actually very exciting, is Semaglutide and Liraglutide both Neuland are working on. Semaglutide is the more advanced project for us because there is opportunity to be the first source for the generic markets. Currently, we are still in the early stages of the development we expect validation complete, maybe in end of FY23. Having said that we are looking at markets worldwide that is a solid oral as well as injectable formulation. And currently we are exploring, both exclusive as well as non exclusive partnerships, but it is a complex project, but we do have very capable teams working on it right now.

Keval Ashar: Thank you and all the best.

Diwakar Pingle: **N**ext question comes from the line of Manish Jain. Please go ahead.

Manish Jain: Thanks for the opportunity. My first question is, what is the current capacity utilization in unit III.

Sucheth Davuluri: So we have about six production blocks in unit III about, four of those production blocks currently we have products running. Where validation batches are complete, we are making small commercials where even within these four production blocks these products are made on a campaign basis so the capacity utilization is still very low. So we don't expect to get to very close to 40% -50% capacity utilization until the end of the current financial.

Manish Jain: So, second question is has there been any market share gain or loss for any of our top 10 products from the GDS segment.

Sucheth Davuluri: We haven't seen any signs of long term market share, gain or loss. What we have seen is that there are some products because of either additional inventory, lower off take because of the impact of the pandemic, we have seen those indications but the overall products continue to grow and any temporary loss in market share, we will pick up the rest of the year, but we haven't seen any significant loss in market.

Diwakar Pingle: The next question comes from line of Abhishek Kapoor. Please go ahead.

Abhishek Kapoor: Good evening everyone, I have got one question. Based on the CMS projects we have as on date and your expectation, what is the likely capex requirements 2-3 years down the line. Whether unit III would be able to survive or we will require capex and how are we going to fund it.

Saharsh Davuluri: I think, for the next 2-3 years we look at unit III as adequate for scaling up, not just the CMS molecules but also the GDS molecules, but we also are being careful to look at certain scenarios where, if there is a higher than expected projected cost, then we will probably have to look at capacities beyond unit III as well. But in terms of capital expenditure, Deepak do you want to answer that question on what is our capex plan.

Deepak Gupta: So our capex plan for all the units put together are similar to last year, so maybe based on the project viability that we are evaluating over the next couple of years. So I hope with similar kind of capex that we have done in the past on a year to year basis for next couple of years. So, we will be doing roughly around 100 crores of capex per year for next two to three years.

Abhishek Kapoor: Will be this on existing unit like maintenance capex, or you will be adding up some things in the existing units.

Sucheth Davuluri: So this includes all the capex put together Abhishek. It includes capacity enhancement, replacement capex, upgradation all of that will be in the range of about Rs. 100-110 crores, as we see as things stand today, but as Saharsh was mentioning, when we see a specific project that requires a project specific capex and has a project specific payback than we will not hesitate to invest in additional capex to make that project successful.

Saharsh Davuluri: I think the only other thing I would add here is that when it comes to capex for CMS projects, we also ensure that there is a very high level of visibility and the certainty and assurance from the customer before we deploy the capex. So having the right contracts, perhaps in some cases even getting advances from the customers to fund some of these capex plans are all part of our negotiations with the customer. So whatever capex we would deploy for the CMS molecules, we will make sure that there is a clear business visibility before we deploy that.

Diwakar Pingle: Will take the next question from the line of Abdul Puranwala. Abdul go ahead.

Abdul Puranwala: Thank you for the opportunity. So, my first question is on what was the inventory amount for the quarter on the balance sheet, if you could provide that.

Sucheth Davuluri: Please ask the second question, we will answer this in the meantime.

Abdul Puranwala: My second question was on the CMS segment. So CMS, as I understand is quite a lumpy business but I would like to understand is within the CMS would it be possible that some molecules for the supplies which have been done, and which are still in the development stage from an absolute revenue run rate perspective, would it be fair to assume that even a development molecule might have a slightly higher sales than the ones which got commercialized, maybe in this quarter or last year.

Saharsh Davuluri: Absolutely Abdul, as way we have said this in the past, our commercial revenues from CMS molecules, maybe around Rs. 100 crores per year range, that's what Neuland currents commercial molecules deliver. We are seeing development projects where validation batches could have very significant high value in comparison to what could be the commercial value of some of the molecule. I think that way there is a very large standard deviation of all the products in the CMS pipeline. We have molecules where in annual revenues could be Rs. 8-10 crores per year. There are some molecules in our pipeline which in the future could be Rs. 100-200 crores per year. So I think there is a huge range over there but it all boils down on how those drugs perform once they are commercialized and so that's kind of where there is a certain level of excitement as well as some uncertainties. Deepak you can answer the first question.

Deepak Gupta: So in terms of inventory we would have as end of this quarter inventory of Rs. 290 crores. So that's where we stand.

Abdul Puranwala: Thank you.

Diwakar Pingle: Thank you Abdul. So, I would ask Shrish Jain to kind of go ahead with this question.

Shrish Jain: Hi. My question pertains to the CMS part of the business. I want to understand how it is exactly billed to the client. Since we are seeing constant dip in the revenue of CMS and we see that we have not been able to deliver the projects. So how exactly are these projects billed to the client like is it post delivery that we receive all the revenue. Just wanted to understand some color on that.

Saharsh Davuluri: The scale of projects, the examples that we were referring to in our opening remarks, there are usually milestone based payments, wherein when we are starting the campaign, we get, maybe 20-30% of the project value which we accrue as advances, and we use it for cash flow for purchasing raw materials. As we start completing the campaign and we start releasing batches, we would raise individual invoices for individual batches and then we will be able to recognize revenue and then, depending on the credit terms we have, which is again project to project we would get cash into the system. So that's typically how it would work. I think in a situation like this, the fact that the project is taking a little longer in terms of execution, we would have probably realized upfront billing in the form of advances, but the majority of the billing which comes in, upon dispatch or delivery of materials would be pending because of the delay in the project. So that's kind of how the mechanics of payments work for scalar projects. In the case of projects which are still in R&D, there is very clearly defined milestones split through the project and payments get made, based on the progress of those milestones.

Diwakar Pingle: Thank you for Saharsh. I will now let Kailash M please go ahead with your question,

Kailash M: Thank you everyone for the opportunity. I see that in the panel on the CMS pipeline, the count for development and commercial is at an all time high. So, can we assume that we will have much higher commercialization and a higher uptake in the times to come.

Saharsh Davuluri: The numbers have steadily increased Kailash. Today I think between development and commercial we seen maybe almost 35 to 38 molecules. What that really indicates is that more molecules are likely to get into commercial, and therefore there is likelihood that the commercial revenues will increase, I think, two comments I could make over here. One is, I had mentioned earlier that there are 4 to 5 exciting molecules in the CMS pipeline which are likely to get commercialized and we expect maybe at least a couple of them to be really successful, and that could help us drive the business. So that something that's very important to share. Other than that, what I would also like to share as an input is that the timelines for this commercialization is something that we need to be mindful of and I am also sensitive to investors who are asking questions about the lumpiness of the business and the growth percentages on a year to year basis. This is something we also struggle with in giving guidance as to when will that commercial revenue start reflecting. I think that is something that we should expect but I would be cautious in saying that these will happen over the next one to two years, and maybe more conservatively over a three years timeframe, and therefore you will start seeing the CMS growth happen over that time. So this is not something that I would anticipate over one quarter or a three quarter kind of time frame, it is something around I would expect 1 to 2 year time. So that's kind of what I would share with regards to the commercial prospects of that pipeline.

Diwakar Pingle: The next question is from the line of Rishabh Kochar from Edelweiss. Please go ahead.

Rishabh Kochar: I have one question. Given that Bilastine has gone off patent in some of the regions, and it would lose its patent on a broader level by next year. So, how does it impact the CMS revenue for Neuland. Can you give some color on that.

Sucheth Davuluri: So, if I understood your question correctly Rishabh, what you are asking is what was that product that got impacted and how do we view it from a future perspective is that your question.

Rishabh Kochar: Yeah, so Bilastine the main drug in the CMS business, which has lost its patent, which is filed by FAES pharma. So is that impacting the overall revenue for Neuland.

Sucheth Davuluri: These kinds of questions which relate to specific products and customers as mentioned earlier, we can either deny nor confirm because of the confidentiality agreements that we have with our customers. We are free to comment on our generic products and how they are doing market penetration volumes and all of that for but unfortunately specific customers and specific customer and product combinations we cannot comment.

Saharsh Davuluri: Yeah and on our overall basis I think the CMS commercial pipeline, without mentioning any specifics we have a mix of products where we are on a quarter to quarter basis we do see a certain level of volatility and uncertainty. But, as Sucheth said specific molecules within CMS because of the confidential nature of the molecule, we cannot really comment on that.

Diwakar Pingle: Thank you. I will take the next question on the line of Swapnajit. Please go ahead.

Swapnajit: I have a single question like how are mix going to be like currently close to 46% is coming from generic API, specialty API close to 25% and rest 30% from CMS. Suppose like five years down the line, how we are seeing the mix proposed to be.

Sucheth Davuluri: We have tried to answer this Swapnajit, is that as Saharsh was mentioning earlier, we are not de-emphasizing any segment of our business. So whether it's prime, specialty or contract manufacturing, as we mentioned earlier we have 300 people working in our R&D, those 300 people are split between our contract manufacturing molecules, our specialty as well as prime development molecules, as well as lifecycle management of our existing molecules. And our goal also is to file 6 to 8 DMF on the generic side, and overall in R&D we are executing about 70 projects per year. So our thrust is on all the three segments, to be able to grow all the three segments as well. Now how that mix is going to change as much as we would like to predict, it is a difficult question to answer because it depends on how successfully some of those molecules on the contract manufacturing and the generic side are. However, what we can say is that we expect all the three segments to grow over a period of time because we are putting a lot of resources and focus on all of these three segments. Hope that answers your question.

Diwakar Pingle: We will take the next question for line up Rajeev Venkatesh. Rajeev go ahead.

Rajeev Venkatesh: So my question is when we look at the business until 2014 we did really exceptionally well. After that, we had some sort of lumpiness in the business. Is this the same trend what we are seeing currently. From past two quarters, the results are not that as per the expectations. So can you just comment on this.

Saharsh Davuluri: I think what we have seen in 2009 to 2014 and I wouldn't like to get too much into the past, but I think that was a situation where we were largely a prime API product company, driven by two products, and with a lot of capital expenditure incurred with a lot of debt the balance sheet, a highly leveraged company and we had kind of been able to reduce and our pay down our debt and we had started to see our specialty business and CMS business kicking in, and a lot of the growth that happened at that time I think particularly one or two years was as a result of one or two products. I think today, our business in a very different situation and we think it's a completely different situation with absolutely no parallel to the past because today our business is highly diversified, we are diversified not just our business mix between GDS and CMS but also within GDS within CMS we have a highly diversified product mix. We have a very healthy pipeline of products that are coming up for scale up, and therefore that gives us a lot of confidence on the future and what stands for us is in the future. Today our balance sheet is actually a fairly strong position we have created a lot of infrastructure in terms of unit III, in terms of R&D for what's ahead. Therefore we have actually a clear runway for the growth. So having said that, today we still face some challenges that come with the lumpiness of the CMS business only because the business is still relatively small. And as we see the business growing from say, Rs. 150 to 200 to 300 to 400 crores revenue scale that lumpiness and that volatility should start reducing significantly and as that happens, I think the business will have a lot more stability. So I think that's kind of how I would probably look at the recent time versus the past. I think it's definitely a lot more diversified and an evolved business at a much larger scale, where we were Rs. 400-500 crores company at that time, now we are closer to Rs. 1000 crores company with the prospective growth rate.

Diwakar Pingle: We will take the next question from line Shrinath V. Shrinath please go ahead.

Shrinath V: I think in the CMS side I mean we do have 6 commercially APIs and 11 intermediates. So the pipeline is improving, that’s really encouraging. So, what I want to know is, generally how is that business like are we the only the first supplier for this or in some of the molecules we are second supplier. So how does this mix going to affect us. I mean, what I am really trying to understand is, suppose if we are a second supplier do we have any visibility for those products in future. We are getting excited about this kind of products in the commercial pipeline but if we are second supplier, are we going to get any business, just we are trying to understand that.

Sucheth Davuluri: Shrinath, your question is specific to CMS or you are asking generally.

Shrinath V: It's specific to CMS. I am only talking about CMS molecules.

Sucheth Davuluri: As Saharsh was saying earlier, our margins when we are the primary supplier are definitely higher but at the same time there's always a risk that you lose a big chunk of that business to a secondary supplier that comes in and gets majority of the volume. So, going back to your question, we have molecules where we are the primary supplier in several cases but also molecules where we are the secondary supply. The difference is that being a secondary supplier we enjoy higher volume with slightly lower margin, being a primary supplier we get definitely higher margin with slightly lower volume so it's a trade off, it’s not this one's better or that one's better, we have to go on a case by case basis. Our goal however, is to make sure that we are as early as possible. We can be the primary supplier, and we are also investing in that molecule, and keep it competitive so that we can get as much volume as possible, that's our ultimate goal that we want to place on the CMS side.

Diwakar Pingle: Thank you. We will take next question from Rohit Balakrishnan. Rohit go ahead.

Rohit Balakrishnan: Thanks for the opportunity. My question is actually on the GDS side, so you mentioned in your earlier comments that you are very selective on your products and over time you sought of try and see market share gains in those products. So just want to understand from that perspective, is there a strategy to gain scale and gain marketshare there. So, would you say that your margins in GDS would probably increase over time and has that happened in the past because some of the previous concalls that I have gone through, it didn’t seem that what you were hinting at. So my question really is that if your strategy is to scale your generic molecule business than one also believe that margin in those products also scale up as lowest cost producer of that molecule.

Sucheth Davuluri: No it’s a clear part of our strategy Rohit. So, our goal is that over a period of time we gain market share but at the same time it’s also not to get to a point where its profitless volume and that’s why in my earlier comment as referring to a large part of our R&D dedicated to our lifecycle management program where we constantly look at our existing molecules late in their life cycle where we have a large market share, and figure out ways to make the process more efficient and remove cost out of the system. Therefore we continue to protect or increase the margins over a period of time. We have seen that from time to time in products such as Mirtazapine, Levetiracetam, Sotalol, Entacapone where over period of time not only have we gained market share but we have also seen our margin for those products increase. It's not consistent, there will be times where we either have competition or they could be temporarily increase in raw material prices or other factors that could lead to a deflation in margin but over period of time, what we said is what our strategy is.

Rohit Balakrishnan: Okay. So, can I just maybe ask one additional follow up on this. So you mentioned that GDS top 10 is like about it 90%. So, these top 10 product in GDS is that like a fairly stable 10 products or these keep changing as part of your lifecycle management. One or two may change but I am saying as a broad basket of 10 products would like a majority of them be stable, like three years back what they were and what they are today, would they be similar.

Sucheth Davuluri: They would be similar, unless of course, a specific product is de-growing or de-cannibalized by another generic launch notwithstanding that your observation is right, they would be considerably stable for a long period of time.

Saharsh Davuluri: I think a lot of the value that we can create, and we have been creating recently are out of products that we have been in the market for 10 years, if you take product like Levetiracetam and Mirtazapine, these products have been on our product list they have been commercial for maybe 10 years plus but in only in the last one, two years we have been really scaling up and actually driving margins also, getting better operating leverage, and doing a lot of lifecycle management. So absolutely, I think the list is highly focused.

Diwakar Pingle: Okay, thank you, Rohit and thank you Saharsh, Sucheth for the answer. In interest of time we are just taking the last question from the line of Manoj. Sameer please go ahead.

Manoj: Just one question I had, mainly on your CMS business to one of the question of previous participants you mentioned that it is because of the execution delays. So if you can give us some color what kind of execution delays, why it has happened and secondly what kind of impact it will have on our customers like where because of the execution delays, we could not supply or deliver the material because we are in the early stage of ramping up the CMS business and for getting repeat business or for getting new customer, I think execution is something which has to be perfect. I can understand like if it is due to external factors, but what happens if it is due to internal factors or execution delays. So just wanted to get some color on this, thanks.

Saharsh Davuluri: So a lot of the projects that we are dealing with in CMS right now are fairly complex molecules and when I say complex molecules, we mean you know an extremely long number of steps of synthesis, the reactions are extremely sticky, that require a certain level of in process monitoring controls, etc. And these are molecules which are going into new drugs, and a lot of times our customers are coming to us with the anticipation that we are able to scale them up to a higher level that they can actually address their market. When we are scaling up these kind of volumes what we could typically see are challenges on process chemistry, process engineering and a lot of these are involved with the complexity of some of these modern reactions that we handle and some of these challenges that we come across are challenges that are very difficult to visualize in the lab, and these are challenges that manifest when the molecules go for production. These are also challenges that our customers anticipate. So, many times when we have conversations with customers for projects they are fairly understanding of the situation and lot of times they help us anticipate these situations. So to answer your question, number one, a lot of these challenges are challenges that come from scaling a very complex reaction these are not reactions that are simple or that are handed by chemical companies, or maybe commodity API companies. Second of all the customers also anticipate challenges when it comes to scale ups because of the complex nature, and what Neuland, we have been very particular about doing is to have a very strong collaborative relationship with our customers to making sure that they are connected with the progress of the project, they are fully updated on what's going on. So, it's something that doesn't really come as a disappointment or a surprise to the customer. It's more about project planning and making sure that we don't have a situation where you know there is a shortage in the supply chain, and they have the visibility to plan for contingencies. So that's kind of how our customers view this and this is how we kind of view it or not necessarily as a make or break kind of situation.

Manoj: Sure, thanks. Thanks for taking my question.

Diwakar Pingle: Thank you, Manoj much appreciate it.

Thank you friends, I think in the paucity of time we have to kind of stop the call now I do see that there are five or six repeat participants, but plus two or three of them who have not asked the question, I kind of noted the names down. Where possible, I will definitely come back to you. I would request you to kind of write to us in case of any specific queries that you may have, and we will try to answer them best. At this point I would like to hand the call over to Sucheth to give us closing comments.

Sucheth Davuluri: Once again, good evening everyone and thanks a lot for your questions. The fact that we are doing this on Zoom, we can also see a lot of messages being exchanged in the chat box and we appreciate your interest in this organization, all the comments, all the questions, and we do appreciate it. Of course there were a couple of questions about the third wave, about quarter to quarter volatility, I think all valid comments. As far as the third wave is concerned, we don't know how much it is going to impact us and whether it will be impacting us or not we just have to wait and see.

I think from a quarter to quarter volatility point of view, as all of you might know in FY19, our quarterly revenue on an average was about Rs. 168 crores, in FY20 that number went up to approximately Rs.190 crores; in FY21, an average quarterly revenue was about Rs. 230 crores plus. So having said that over the last three years, we have grown consistently we have repeatedly said in these calls that we do expect quarter to quarter volatility given the number of projects, the contract manufacturing business and you know as an earlier question was is when the project get delayed, does it really impact our relationship with the customers. We believe it doesn't because Neuland takes pride in the fact that we are very transparent to our customers and lot of times the projects do get moved down to the next quarter and in the best interest of the project. It's not because of inefficiency in the project or because we are not meeting the need for the customer. In fact, because we are trying to meet the need of the customer, that’s why the projects actually get extended by 30 days or 60 days, or sometimes even longer. Having said that, the overall business of Neuland as I summarized it earlier on the generic side as well as the contract manufacturing side, continues to be strong. We continue to develop molecules on the generic side, gain market share. You have already seen the numbers of projects that continue to increase on the contract manufacturing side and given those numbers is where our optimism for the business and the belief of the business is coming from. So yes, we do expect that short to medium term volatility but as we have shown in the last three years and even longer that the overall business, we can continue to grow and perform and meet our margin targets as well as our revenue targets. Once again, thanks a lot for interest in the company, that should end with this call please continue to reach out to us and we will be happy to answer your questions.

Thank you. Thanks Diwakar and Ravi for doing this, and everyone else for making this call.

Diwakar Pingle: Thank you guys. That kind of concludes the Q1FY22 earnings call, and as mentioned any specific queries please reach out to me or Ravi, and we will be able to answer that to the best of our ability. Bye and have a good evening.