"Neuland Laboratories Limited Q4 FY20 Earnings Conference Call"

May 22, 2020

MANAGEMENT: **MR. SUCHETH DAVULURI - VICE CHAIRMAN & CEO, NEULAND LABORATORIES LIMITED**
MR. SAHARSH DAVULURI – JOINT MANAGING DIRECTOR, NEULAND LABORATORIES LIMITED
MR. G. V. BHARADWAJ – DGM (FINANCE), NEULAND LABORATORIES LIMITED

Moderator: Ladies and gentlemen, good day and welcome to the Neuland Laboratories Limited Q4 FY20 Earnings Conference Call. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Diwakar Pingle from Christensen IR. Thank you and over to you, sir.

Diwakar Pingle: Thank you, Janice. Good afternoon friends. Welcome to the Q4 and the full year FY20 earnings call of Neuland Laboratories. To take you through the results and answer your questions today, we have with us the management team from Neuland Labs represented by Sucheth Davuluri - Vice Chairman and CEO, Saharsh Davuluri - Joint Managing Director and GV Bharadwaj - DGM, Finance. We have sent out the press release as well as the financials and we have also sent a small FAQ document which captures some of the standard questions that you do not need to ask on the Q&A session take a look at that sometime when you get a chance.

Before we start, I would like to say that everything that is said on this call which reflects any outlook for the future which can be construed as a forward-looking statement must be viewed in conjunction with 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 subsequently in the annual reports which you can find on the website.

With that said, I will hand over the floor to Saharsh who will run through the business highlights of the year gone passed and just delve a little onto the financials before throwing open the floor to Q&A. Over to you, Saharsh.

Saharsh Davuluri: Thank you, Diwakar. Good evening friends, a very warm welcome to all of you joining this call.

I will first touch upon the business highlights of the year that has gone passed and some of the key highlights of the financials, after which we will open it up for Q&A. This time I am not going to call out individual numbers for the quarter since we do not want to get into too much of a monologue and in any case you should find these numbers in the press release and on the website.

Before I begin, I hope all of you are doing well and are safe in confines of your home. So on the business front, things have opened up gradually for us and you would have seen the consistency in the performance at the topline and the margin levels over the last 3 quarters. This quarter was also relatively a strong quarter for us despite some headwinds due to the COVID-19 related lockdown especially in the second half of March. While our plants were working with skeletal-staff and production was on, the outbound logistics and supply chain were impacted and this resulted in us not being able to deliver goods to our customers worth approximately about 15 crores.

On a full year basis, we closed FY20 with revenues of 766 crores as against 670 crores in FY19 on a standalone bais. This represents revenue increase of about 14.4%. The EBITDA margin also stood at 13.7% which was roughly 450 basis points higher than the margins of the previous year. The margin movement is on the back of both actual growth in revenues as well as improvement in the business mix and we are confident that our portfolio mix will continue to shift more towards value-added segments in the years to come and we should be close to our aspiration margin profile.

Coming to the CMS business, we are pleased with the way the business has performed in the year. We have always believed that CMS would drive both growth and profitability. The business grew 105% in FY20 over FY19. The number of CMS projects contributing to revenue in this particular quarter has also grown up to 25 compared to 12 a year ago. This includes both projects that are commercial as well as those under clinical developmental stage. The overall pipeline of projects continues to increase and we are now pursuing more advanced projects with closer cycle times through commercialization. We have also provided you with the CMS pipeline data for the past few years and you can always check the data for our performance and progress over the quarters.

Another important update that I would like to share is on the status of Unit III. We are happy to state that Unit III is almost in a state of readiness and for FY21, we expect to have meaningful contribution from this unit.

The other issue that I would like to share in the opening remarks is the tax treatment for this quarter. We have opted to be taxed at concessional tax rate of (+22%) plus surcharge and cess under the recently promulgated ordinance. The reduced tax rates come with consequential surrender of specified deductions or incentives. So consequently, the opening deferred tax asset has been measured at a lower rate with the one time corresponding charge of 23.25 crores statement of profit and loss. But for this charge, the PAT would have been higher by this amount.

Our debt levels continued to be at a comfortable level. We will end the year with similar debt levels as last year. The total debt of the company as on 31st March 2020 was 259.59 crores and the cash and bank balance was Rs. 45.69 crores. So with these updates, I would like to open the floor up to Q&A. Thank you.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. We take the first question from the line of Sanjay Kapoor, individual investor. Please go ahead.

Sajan Kapoor: I have two questions. Number one question on our custom synthesis business for innovative molecule. So you guys are mainly focusing on areas where we have strong technical competence or things like **deuteration,** peptides etc. So on the peptide pipeline, the last update was that there were about 9 to 10 molecules in the CDMO and those are the ones that passed the clinical Phase-and 2-3 out of those 10 were in fairly advanced stage as far as the commercialization is concerned. So is it fair to expect some sort of commercialization on the peptide APIs in FY21 or is it more like in FY22? Thank you.

Saharsh Davuluri: So in terms of the progress we have been making, I think your analysis is very accurate. The number of molecules in development and commercial pipeline has increased over the past year and molecules in these two specific categories are closer towards commercialization and as we have indicated, we have had couple of molecules in comparison with our Q4 FY19 to now. We have had couple of molecules go up from 13 to about 17 in the development Phase-and from 14 to about 15 in our commercialization phase. Some of these molecules are generating part of the growth of our revenue and some of the revenue growth is also coming from the increase in the number of projects itself. Some of these projects are peptides, but a large part of them are actually small molecules and we do expect in the years to come that these will get commercialized, but at this point because there are certain clinical uncertainties involved in the process. We cannot say for sure whether they will be a peptide or not in this basket.

Sajan Kapoor: Sure. And these peptides, you are still working with the liquid stage peptides, right, non-oncology?

Saharsh Davuluri: Yeah, we work across different therapeutic areas. Basically, what we do is solid phase, liquid Phase-and hybrid phase. We do not do any non-synthetic peptides.

Sajan Kapoor: Okay, understood. And secondly the question is that countries across the globe are looking to reduce their high dependency on China especially in light of this COVID scenario and most governments across the globe, US, Europe, Japan and Indian have been vocal about domestic production of APIs. Now just playing devil's advocate here, if the various KSMs and intermediates are not being produced locally in a specific country, it could be US, could be Europe, could be India. How can the end-to-end supply chain be indigenous in derisk from dependence on China because you have to move the end-to-end from KSM to intermediates to API. Everything has to be locally hosted to make that country self-reliant. What are your thoughts around this, please?

Sucheth Davuluri: You see the way we are looking at the current situation is I think it is a good opportunity for Neuland and other organizations to move their supply chains closer to their home. So I think increasingly as we think about our supply chains, we are not thinking more in terms of whether it is India, China, Europe or US, but we are definitely looking at ways to shorten our supply chain, qualify additional sources which are much closer to our facilities whether that be in India, in Eastern Europe, Europe or China. I think what we are going to note here is that we are not saying that we need to completely mitigate the risk against China. What we are definitely saying is that as far as all our key starting materials as well as raw material are concerned, we need to have multiple options so that our supply chain is not significantly impacted by a country or a particular geography. So we are taking a well-balanced approach. I think saying that we do not want to buy from China would be kind of a kneejerk reaction. Countries and companies attempted the same thing when there was SARS epidemic, but it really did not work. At the end of the day, we must balance what is best for our business while reducing our risk as well.

Sajan Kapoor: So you do not see any risk on Neuland because a large portion of our cash flows and revenues originate from Europe and US as well. So you do not see a potential threat that those countries will start moving supply chain closer to home which might impact Neuland's performance.

Sucheth Davuluri: So I would not say that we do not see any risk at all. I think the current situation is volatile and will have to see how the situation develops, but pharmaceutical services and products being essential services, we do expect that the demand will continue and the demand will continue to be strong from US, from Europe and other parts of the world. And for that reason we are looking at every part of the business, revaluating given the current scenario where the inherent risk could be and what steps Neuland can take to mitigate some of those risks.

Moderator: Thank you. We take the next question from the line of Abdul Puranwala from Anand Rathi. Please go ahead.

Abdul Puranwala: Sir, my first question relates to the CMS order book. So sir clearly this year we had a very good year on the CMS side. So going forward how should we look at this particular segment, would we be able to sustain the growth momentum for the next year?

Saharsh Davuluri: So Abdul, as I was mentioning in the opening remarks over a 100% growth in terms of CMS revenue in FY20 versus FY19 and this growth has been triggered both in terms of increase in the number of projects and also because of higher contribution from some of the more advanced projects. And the nature of the CMS business is such that the cycle is also very long, so our order visibility etc. is also reasonably longer compared to our GDS business. So based on that, we feel pretty confident about achieving a decent growth in FY21, but I would not really give a guidance of any sort in terms of what would be the growth or what is the value of the open order book. But we are confident that the growth and the momentum in the CMS business will be sustained. It is not a one-time thing that we have seen in FY20.

Sucheth Davuluri: And as Saharsh was saying earlier, Abdul, that CMS is a very strategic focus for us. We have been saying in all consecutive investor calls every quarter that this is a big focus area. It will contribute to our growth and we are making a lot of investments in this area. Therefore we continue to do that. We are seeing the business pickup and there is no reason why we expect this to slow down.

Abdul Puranwala: And second question is related to the GDS segment. So last quarter that is third quarter and fourth quarter, we have seen very good spike in certain API prices. So with the margin expansion in this quarter, would be largely attributable to the spike in raw material and the prices of the key APIs what we supply?

Saharsh Davuluri: See, I think if you look at the GDS business, Abdul, FY19 was little bit of a challenging year for us in terms of our margins. I think there has been some relief especially in the second half of the FY20 financial year as we were able to get slightly better pricing, have better control on our cost of raw material through process improvement programs and initiatives as such. So yes, as we have recognized the improvement in GDS margin is there in FY20 and I think even looking at the business today into the future, we feel that we are in a reasonable position. So it should hold onto where it is and maybe gradually also gets better over time.

Sucheth Davuluri: Just to build on that, Abdul, I think our margin expansion is not because we have increased our prices to customers. It is because of a change in our business mix as well as our product mix. As far as price increase is concerned, the only area where we would increase our prices is where we have seen a significant increase in cost from our suppliers because of very significant restriction in our supply chain, but as you can imagine, it is also important for us to maintain the trust that customers have built in us where we are not using this opportunity to give any artificial or inadvertent price increases. I think we are doing everything we can to protect our customers and keep the demand strong.

Abdul Puranwala: Sure sir, understood. And just a final question. So, what would be reliance on imported Chinese raw materials for FY20?

Sucheth Davuluri: That is a tough question to answer, Abdul because we break our procurement into direct procurement and indirect procurement. So, we may not be directly buying from China, but the suppliers that we are buying from India or Europe or the US could be buying this basic material from China as well. So the focus that we have is to make sure that we are buying our materials from very reliable sources whether that is from China or India or Europe or US and also qualifying suppliers that we give us much more control over our supply chain closer to home. That is our focus for our supply chain.

Abdul Puranwala: And just last final question. So would you like to guide us anything on the tax rate going forward. Would it be 25% or slightly below that?

G V Bharadwaj: It would be 25%, Abdul.

Moderator: Thank you. We take the next question from the line of CM Lodha from Sanmati Consultant. Please go ahead.

CM Lodha: I have two questions, sir. Number one question is regarding Unit #III. How much CAPEX we have incurred in Unit III sir?

Saharsh Davuluri: I think we have not disclosed specific numbers for CAPEX for Unit III, Mr. Lodha. In terms of acquisition we have made some investments to bring the plant into an operational status, but we have not given specific CAPEX details.

CM Lodha: When we can expect completion of this CAPEX in Unit III sir, timeline?

Sucheth Davuluri: So Mr. Lodha, what we are doing is that we have already scaled up two products in Unit III and another two products are going to be scaled up this year. So we expect complete commercialization of Unit III starting in August-September of this year.

CM Lodha: August-September of 21?

Sucheth Davuluri: Yes, of the current financial year, you are right, FY21.

CM Lodha: Okay. My second question is sir, I was going through the information filed with stock exchanges, the company was having a land at Nanakramguda in Hitech City in Hyderabad.

Sucheth Davuluri: Yes.

Participant: That land has been given to some Phoenix builders for promotion of the land. So what is the status of that construction or when the project can be completed by the builder, sir?

Saharsh Davuluri: So, the project itself is joint development project and it was entered into with this Real Estate company called Phoenix and it is a 5-acre property that was allocated to Neuland Labs and Neuland Labs in turn entered into a joint development agreement with the builder. The builder is currently constructing a commercial real estate building which will be completed in the near future and as part of the development agreement, there is a specified share of this square footage which will be handed over to Neuland Labs which Neuland Labs can monetize in different ways.

Sucheth Davuluri: And whatever disclosures that need to be made, we have already made, it is all available in the public domain, Mr. Lodha.

CM Lodha: Okay, sir. Thank you. I have a last question regarding debt reduction in the company. Any view on the debt reduction or current debt?

Sucheth Davuluri: See, currently our total debt in the company is about 259 crores, Mr. Lodha. Our working capital utilization is ranging between 60% plus or minus. Our overall term loans are about 90 crores approximately and we will be paying back another approximately 25-26 crores this year. So we feel that our debt is significantly under control. Our liquidity is healthy and therefore we will continue to focus on growth of the organization right now.

Moderator: Thank you. The next question is from the line of Ravi Sundaram from Sundaram Family Investment. Please go ahead.

Ravi Sundaram: My first question is on CRAMS business, your CMS business. So, was there any lumpiness in this quarter and you had mentioned to the previous participant that this growth can be sustained.

There has been a significant growth compared to FY19. I think around close to 100% is what you mentioned. At what rate of growth can we expect to grow, would it be 30% from this space for CMS or would it be 40%. Any color on that front?

Saharsh Davuluri: So, as I was explaining to the gentleman earlier, our CMS business visibility is quite strong because the pipeline has evolved and today, we have more attractive molecules in our advanced pipeline. And for many of these molecules, we also have order commitments, contract etc. in place. In terms of growth as you know, we had a 100% growth over the previous year. But in terms of going forward, I would be cautious in giving any specific number as a guidance, but we expect growth to be strong and sustainable. As we have mentioned in our past commentaries also, over time we expect CMS business will be about a 1/3rd of our overall business. So if you look at our overall growth, then you look at that as a rough guidance, you can expect a decent consistent growth year-on-year. But I would be cautious in giving you more specific guidance on this because it is still a new business and it is evolving. So we don't want to anyway give a wrong direction.

Ravi Sundaram: Okay. That is helpful. My second question is on, if you see the current quarter, there was good amount of price appreciation for APIs. My question is, for the current quarter's good performance, how much of it would you attribute for the better price realization that you got from APIs. What I am trying to understand here is, was it due to better prices that you got for your prime segment APIs or if that is the case, would it be sustainable in the subsequent quarter?

Saharsh Davuluri: So, I think what we have seen and what you are referring to as price appreciation in Q4. Ravi, I would say that one is a representation for the year itself. I think barring the first quarter of the year, we have had a good run in terms of our contribution margins on the GDS business as well. And also as Sucheth was responding to one of the earlier participants, the margin improvement has been actually more a factor of our cost reduction initiatives across both the prime as well as the specialty segment. Our team have worked really hard in either backward integration, upscaling, process engineering, various initiatives of cost optimization to bring the cost down and therefore protect our margins. There may be certain cases where prices have gone up, but definitely I would not say that the flavor of FY20 has been price increase because generics is a competitive market and our sustenance is largely based on our ability to stay on par with competition on pricing.

Ravi Sun daram: I think that makes sense. The third question in on, the current quarter had a significant impact due to lockdown. They did have a meaningful impact on your utilization in the first half of this quarter and if yes, would it impact your performance in Q1?

Saharsh Davuluri: See, as I mentioned in the opening remarks, there was impact initially in terms of outbound logistics and for Q4 we have been able to quantify it. And I did mention that it was an impact of about 15 crores that was due to be dispatched,but could not be dispatched. When it comes to Q1, the impact of the COVID-19 had continued especially in the month of April where we had challenges on staff, outbound logistics, supply chain, various issues implementing social distancing norms in our workplace etc. So as a result we had to run our operations very carefully especially in the month of April and as a result of it, we were suboptimal in our execution and we had to rationalize by prioritizing certain products, certain customers depending on the need of the patients in different markets, etc. So I would definitely say there has been some impact, but we are very proud of the way our teams have performed and we have bounced back. But I would stop short of trying to quantify anything with regards to Q1.

Moderator: Thank you. We take the next question from the line of Pritesh Vora from Mission Holding. Please go ahead.

Pritesh Vora: Sir, can you highlight the pipeline of drugs which you are in the process at present and what is our capacity enhancement plan over the next 3 to 4 years?

Saharsh Davuluri: Yes, so our drug pipeline, I think we have two kinds of pipelines. One is on the generic side, the new generic molecule that we are developing and on the other side for the CMS, the customer projects that we have been working with. And right now we have several molecules, the data has been provided in the press release as well. We have several candidates which are commercialized or near to commercialization. On the generic side as well, we have several molecules which we have published in our product list which is also on our website. And while I cannot disclose the names of the products in our CMS pipeline because those are confidential, I can share that some of the exciting molecules on our GDS side are like paliperidone palmitate. We have other molecules like Dorzolamide, Brinzolamide, Salmeterol, Ezetimibe. So they are at least about 8 to 10 molecules which are largely in our specialty category and then a few in the prime category as well which are growing really well and a big part of the growth we are seeing right now is driven by some of these molecules. Most of these molecules, the patents are either just expiring or they will expire in the next 1-2 years. So we will see further growth from them over the next 2-3 years as well. On the CMS side, as these drugs get commercial which means the innovator launches them in the market, we will see increased volumes from those drugs as well. In terms of growth, both the segments are quite prospective for us. So we are excited about the pipeline. The capacities we have are very fungible capacities and Unit III is also giving us lot of additional capacity. So we are carefully utilizing our capacities of not only Unit I and Unit II, but Unit III to optimize this product mix and sustain the growth.

Pritesh Vora: Right. And sir, can you highlight what is the capacity enhancement plan? I mean, we have lot of debt on the book. So do we have a plan to put more plant in order to bring those molecules into production or how do you fund those expansions?

Sucheth Davuluri: I think Saharsh answered that question to a large extent. Between Unit I, Unit II, Unit III, especially after our CAPEX investment, we believe that we have created enough capacity for the next 2 to 3 years to ensure that we are able to manufacture molecules both on the GDS side as well as the CMS side. Obviously, the CAPEX program will continue for upgradation and replacement activities. But with Unit III coming online, it gives us adequate capacity to launch our molecules and expand the existing molecules.

Pritesh Vora: Right, sir. And sir, last question is, what happened in 2018 where gross margin and the EBITDA margin fell during that period of time, is there any particular product liable for that fall during that period of time?

Sucheth Davuluri: I think we had clarified that on previous calls. I think that year our margins fell because our product mix had hit a temporary roadblock. Second, we had some imbalance in capacities where we received more orders from one unit versus the other. So we had invested a lot in rationalizing those capacities whose impact we saw both in FY19 as well as FY20 in terms of sales growth. We also saw lower growth in our CMS business that year which impacted the margins and we have seen that has come back to the normal levels in FY20 as well. So we had mentioned in those calls that the pressure on margins were more temporary in nature and that the organization was taking the necessary steps in terms of cost reduction, product rationalization, focus on specialty APIs as well as CMS business which you have seen come back in FY20.

Moderator: Thank you. We take the next question from the line of Keyul Ashar an Individual investor. Please go ahead.

Keyul Ashar: So, basically I have two questions. So the first question is what percentage of revenue addition we can expect from Unit III?

Saharsh Davuluri: So, we won't give a direct quantification for that question, but the way we are seeing Unit III function is that, as it gets operational we are going to start scaling our products in Unit III which would in turn create capacity for us in Unit I and Unit II for other products. So in a way we expect Unit III to get commercialized in FY21, but we don't really have any specific guidance or revenue target for Unit III. Ultimately, the goal for us is to meet all our customer's demand using Unit I, Unit II and Unit III.

Sucheth Davuluri: You want to get a sense of how much Unit III can contribute, you can just do a rough calculation because the current revenues are coming primarily from Unit I as well as Unit II and Unit III has a similar capacity if not more. So that is why we expect that the Unit III capacity should be adequate for the next couple of years.

Keyul Ashar: My second question is, what is the hit that we can take in revenue in Q1 FY21 due to COVID-19, like do you have any idea if you can give us?

Sucheth Davuluri: So, currently we have not quantified that because we are doing everything, we can to make sure that we are able to deliver the orders in Q1 for FY20. Saharsh has mentioned that it was about 15 crores for the whole year, if there is an impact in Q1, we will let you know but right now we have not calculated that because we are doing everything we can to deliver our orders.

Keyul Ashar: And the last question is like, have we got any government's boost or support on the API and pharma thing?

Sucheth Davuluri: Not yet because whatever schemes have been announced by the government are more to encourage investment for chemical manufacturing. They have not really announced any schemes that will directly benefit pharma or API, but we are keeping a close watch on all the circulars which are coming out and we will ensure that we take that into consideration. Of course, in the meantime if you come across anything, please be so kind to let us know as well.

Moderator: Thank you. We will take the next question from the line of Rohit Balakrishnan from VRDDHI Capital. Please go ahead.

Rohit Balakrishnan: Sir, if I look at your CMS business, over the last few quarters or a couple of years our total number of projects has almost doubled from FY18 levels currently. However, the largest accretion has been on the preclinical side. So I have actually two questions. So one is, you have been alluding to this point that this business is still in the nascent space. So one question is how you see this business in terms of projects, what is the critical mass for you to sort of say that for this business you have enough projects which can sort of, unlike what happened in FY18 where the revenue sort of declined because the base was lower. What kind of levels do you see in terms of project size, you now say that it is stabilized or is there more to go there That is one. And secondly sir if I look at the breakups, a large part is still on the pre-clinical side, in one of the questions to the earlier participant you mentioned that many of the projects are now moving towards development or commercial space. So if you can just share a bit more on that? These were the two questions.

Saharsh Davuluri: I think, as you rightly recognized, total pipeline has increased a lot over the last couple of years. I agree with you that a big part of this increase, almost doubling of the numbers has happened from pre-clinical. However, what I would like to point is that, if you see approximately two years ago, the number of projects we had in development were 5. Today with the number of projects we have in development are 17 and the number of projects we had in commercial two years ago were 10. Today we have 15 projects in commercial. Numerically this numbers may seem small, but these numbers are what are going to drive the growth of the CMS business. You are right that increasing the pre-clinical numbers is not really going to give us a lot of growth in terms of numbers. But at the end of the day when we are building relationships with clients, we are building relationship with projects across the spectrum. What we are excited about when we talk about the CMS business is the numbers that are increasing on the development and commercial side and definitely it is a good growth, in terms of the total. I you just take the total of the two, the number was 15 two years ago, that number is 32 today. So we are quite excited about that and these are the projects which will give us the revenue growth and I think you also asked a very important question. Ultimately if these molecules become successful and we hope they become blockbusters, they will give us a better stronger growth for CMS, but at the end of the day, unless we go through that cycle with our customers, we also cannot safe assure how exactly the growth will be but the increasing share in the numbers give us the confidence that the business is scaling up and we feel that now we are slowly getting to a comfortable level that we can say that CMS has a critical mass.

Rohit Balakrishnan: So two follow-ups actually on this, so you are saying around 30 odd numbers between development and commercial that you think is closer to the critical mass**,** so should I take that as a statement from you?

Saharsh Davuluri: Yes, ultimately I think why I say this is in FY19, we had a dip here compared to FY18 on CMS, but FY20 we had a resounding growth of 100%. Now, today when we look at the pipeline with these 32 projects and we look at what our customers are thinking about future expectations of these molecules, we feel reasonably confident that we will not be subject to those kind of cycles with this kind of size of molecules. So please also understand that it is our interpretation that it is a base but ultimately we can't guarantee that statement.

Rohit Balakrishnan: Sir, just another follow-up on this, I wanted to understand like for example, in Q4 also, we had a decent amount in both development and commercial which is about 28 but the revenue traction was not much in that year, so just wanted to understand how does the overall traction or buildup in the revenue happen? What is the cycle? I am not getting into specific share but just wanted to understand the ramp up that happens typically in this business. With that it takes even after these projects are in development or commercial, it takes still some more time for the revenue to ramp up or is it like you have a few projects and then one of them will take off?

Saharsh Davuluri: I appreciate the keenness of your question. I think the way we do it, it is difficult to track these kinds of opportunities. Whenever we get a project and we get a PO for that project, it gets tracked in the number part, so that is why you would have seen, if you see a bump up in the number, it means that a new project has started at Neuland. But many times, the project starts with only 15 lakh or a 20 lakh kind of a purchase order and innovatively over 6 months or a year or 2 years, it becomes a slightly larger project. So the number may not have a direct correlation with the revenue that we are doing in that quarter or even in the quarter that comes afterwards because every project has different kind of cycle. Sometimes, we start up with a very high value project itself, especially for late stage molecules, so I would use these numbers more for getting a medium to long term sense of the health of the CMS business, but not as a way to predict whether our subsequent quarter is going to be stronger or not because I mean spending so much time we don't find any correlation in terms of near term performance. Only medium term to long term, there is a good correlation.

Moderator: Thank you. We take the next question from the line of Saket Kapoor, Individual Investor. Please go ahead.

Saket Kapoor: The question is on the unit economics as well as the synthesis of Prime APIs like Ciprofloxacin, very different from complex chemistry molecules like a Dorzolamide or even the Salmeterol, Sugammadex and so on and again I need some sort of clarification if possible that my guess is that you need Unit III mainly for prime APIs intermediates and KSM and not for specialty or custom synthesis at this stage because we haven't qualified that unit with US FDA etc., so we cannot start serving our custom synthesis customers or even specialty APIs from Unit III?

Saharsh Davuluri: I wouldn't make such a hypothesis because I think even if you look at Unit I and Unit II, the way we manufacture our products is we find either existing suitable equipment or we modify an existing line or build a new line that would be more suitable for that specific molecule and that is what we have done over the years and that is what will happen in Unit III as well because for every product, the technology that we employ is unique and we modify that particular production line to suit that product. With Neuland as part of the manufacturing strategy, we have never really earmarked any specific manufacturing unit saying that this is for specialty and this is for prime. What we do is we earmark each production line, whether that is for prime molecule or specialty molecule, so there is no such thing, therefore we can expect a similar product mix in Unit III that we have from Unit II as well as Unit I. That is our strategy going forward.

Saket Kapoor: That is sure and is there any spare land on this Unit III for brownfield CAPEX because I understand that once this Nanakramguda Joint Development Agreement is ready, may be your corporate functions, etc., or may be the lab itself could move there and some capacity would be created for brownfield on Unit I and Unit II as well, so what is the future growth optionality as far as the available land bank is concerned?

Saharsh Davuluri: Yes, there is available land bank in Unit III for further expansion; however, we don't intent to move any corporate functions there but there is a land bank available.

Saket Kapoor: But the corporate could move to Nanakramguda project once that is ready in few years?

Sucheth Davuluri: We haven't really commented on that.

Saharsh Davuluri: Nanakramguda is more of a joint development agreement for a real estate venture so the way the company is looking at that property is that it is a real estate property for the organization, so we may monetize it in many ways, but we have not really considered moving into it for office premises because we have an office premise in place.

Sucheth Davuluri: We will take that call much closer to the actual event. Right now, it is too early to comment.

Moderator: Thank you. We take the next question from the line of Deepak Poddar from Sapphire Capital. Please go ahead.

Deepak Poddar: Sir, in your opening remarks you mentioned that because of your product mix improvement and as well as cost reduction initiative, we are looking at improvement in our EBITDA margin and expect to reach our aspirational level, so just wanted to understand what is our aspiration in terms of margins?

Saharsh Davuluri: See, we have mentioned in the past that overtime, we would like to get to 20% EBITDA for the overall business. So I guess that is something we could consider to be aspirational, although we would always continue to try to exceed that number as well but that is what we had in mind.

Deepak Poddar: And what is the timeline we are looking at?

Saharsh Davuluri: Nothing specific, I think for us our margins is also very dynamic based on the business circumstances and things like that so we wouldn't want to give any specific timeline.

Moderator: Thank you. We take the next question from the line of Akshit Jain, Individual Investor. Please go ahead.

Akshit Jain: The CMS division is attractive in multiple ways, so it gives us chemistry skills and let us use our chemistry skills, it gives access to clients, so we will produce commercial skill molecule. There could be a good competitive advantage when compared to extremely competitive GDS segment. My question is, can you guide us on the working capital cycle for the CMS segments. Since we are making custom products for our clients and we have low cost setup in India and we have a required chemistry skills, so are we able to demand better working capital terms such as may be advanced payment or let us say receivables compared to the GDS segment?

Saharsh Davuluri: Broadly speaking, we have not seen a remarkable difference between the working capital cycle of our CMS and GDS because in the CMS business, we get advances and we execute the projects and then we are able to recognize revenue. The credit terms of our CMS customers are also almost similar to what we see on the GDS side because most of our customers are blue chip and for our generic customers also, we command a good payment credit term. The other thing of our CMS business is that we end up having slightly longer inventories, we hold inventory for a slightly longer time because we buy raw materials ahead of time and sometimes hold them for slightly longer period while we are taking campaigns and things like that so we have not seen a significant difference. There might be a marginal difference. Anything Bharadwaj you want to comment on that?

Bharadwaj Gollapudi: I think that is fine.

Akshit Jain: And the whole industry also operate, now in CRAMs. CMS industry also operates in similar lines, is it?

Saharsh Davuluri: Because see the definition of CRAMs is also very wide. Our business is mostly with US, Japanese, midsize biotech companies. Some companies define CRAMs very differently, so.

Akshit Jain: And my second question is, I remember that this was addressed earlier and I think a couple of three conference calls back, but can you guide us on the competitive nature of the CMS segment currently, other API makers from India or from China who could probably be a threat to us and what advantage do you think we have over them?

Saharsh Davuluri: I think it is a very vast space, some report says that it is a $60 billion industry and our experience has been that since it is such a big space, we don't end up meeting the same competitors with our customers. So for example, if I am competing for a project in Japan, I end up seeing different CMOs that we are competing with. If we are competing for a European project, we see a different set of CMOs. Typically, CMOs would be Indian, some European and few Chinese and ultimately Neuland strength and Neuland strategy is to work on complex APIs which are in the mid to advance clinical stages and we typically work with small to mid-sized biotech companies. So that narrows down our target market and we have not found one or two names consistently, so I am not really able to recall any specific names.

Moderator: Thank you. We take the next question from the line of Saravanan Viswanathan from Unifi Capital. Please go ahead.

Saravanan Viswanathan: I want to understand the working capital situation currently and I am assuming that COVID will have some impact and how do you expect FY21 as a whole to pan out?

Saharsh Davuluri: As we had explained to a gentleman's question earlier because of this whole lockdown being implemented etc., we have had some impact on our operations and specifically in the month of April we had to run our facilities with skeletal staff, we also faced disruptions, supply chain, outbound logistics, manpower movement, etc., and also we have to take proper timeouts for social distancing implementation and things like that. So as a result, there has been impact and as a result of that impact we had to do some rationalization in determining which products to manufacture, etc., based on customer priorities and all that but having said that being part of the essential services industry, we have also kept up with our responsibilities, our teams also have really worked hard to make sure that they are out there. So I would say that we have had impact and that impact has been largely in the month of April but we do continue to face that impact and I think going forward also we tend to be cautious and there is also always a risk of specific employees in our site's contracting COVID-19 etc., so we operate in this realm of new uncertainties, so it would be very difficult for us to quantify what kind of an impact we will have in FY21 but the silver lining is that our demand for our products from our customers remains strong and hopefully we will be able to recoup and deliver, so we are not too concerned but we are obviously very cautious at this time.

Saravanan Viswanathan: Second question is on the margins front, leaving aside Q1 FY21 where there would be some obvious impact but the Q4 margins that you have delivered, does it represent sort of new normal or do you expect some band there also?

Sucheth Davuluri: I think the margins for FY20 would be more representative because as we have said in calls earlier, we always see a quarter-to-quarter variation into our business like us, quarter is too short to make any judgement on margins or any growth or decline, so I would say that looking at a full year it is more representative of the overall performance of this time.

Saravanan Viswanathan: And then the CMS business becoming one third of your product mix, would that coincide with your aspirational margin target of 20%?

Saharsh Davuluri: Yes, see if we do a very hypothetical simulation, then when CMS is at one third of our total business and the product mix is also optimal, then we should be reasonably close to that 20%, but again saying it with the sense of caution because CMS also has various projects, each project has a different kind of a margin profile, so things would have a certain level of uncertainty.

Moderator: Thank you. Next question is from the line of Mukesh, Individual Investor. Please go ahead.

Mukesh: Sir, what is the CAPEX plan for the current year?

Bharadwaj Gollapudi: Mukesh, I think in our earlier calls we have given our guidance specifically to be in line with in general of 20-30 crores of regular maintenance CAPEX but overall tend to be like 75 to 80 crores in the current year.

Mukesh: And sir, as you were talking earlier that we might have got a hit on the business in the month of April, so is it like we have lost that business, or we can make up for that business in the coming months?

Sucheth Davuluri: So far Mukesh, there is no business that has been lost like we were saying earlier. I think because of the whole situation, we saw a slight postponement in the fulfillment of the demand but we expect the business to be intact.

Moderator: Thank you. Next question is from the line of Kunal from Max Capital. Please go ahead.

Kunal: Question on the customer profile against the planned profile. So I think in a couple of two or three points ago you mentioned that we are primarily catering to US, Japanese and so on and so forth, small to mid-size biotech firms, correct? Now are we seeing any sort of change in terms of inquiry use or anything from this sort of customer base and second, before we do that can you give me a broad sense on the customer profile that you guys are targeting, so if you can quantify, for example by geography are we looking at primarily 80% US and 70% Japanese with the sprinkle here there in European in terms of size are we looking at $100 million kind of a company or are we looking at $500 million kind of a company and then so on and so forth, just want to paint a picture of your customer actually?

Saharsh Davuluri: I think in a nutshell, in Japan we work with almost all the companies in the top 20 categories so there is no focus on mid-size or small companies when it comes to Japan. When it comes to US, the focus is more on small to mid-size and what we typically mean by small to mid-size is that companies with 50 to 500 employees, companies which may be listed but are not really in the big pharma category. And in terms of the spread or mix of our business, it kind of evolves and every year is going to be different because it depends on which projects contributed more in that particular year but I would say our largest market is the US and followed by Japan and Europe which is also fairly close. So that is kind of the mix right now but we expect that it could evolve depending on how the different molecules perform.

Kunal: And if you were to translate this sort of mix, so hypothetically let us say two-thirds and one-third is equally split between Japan and Europe, are the numbers that you project in your pipeline sort of in proportion to that or are they different? That is sort of part one of that question and second is if you know just help correlate, I know you said it is easier to correlate on the medium to long term response to a question you asked for, but in terms of the numbers of pipelines that you have or molecules in the pipelines that you have, is there an average minimum that you look at or how do you help somebody who is outside this business like me quantify this because even in the medium to long term you might have one blockbuster molecule and that takes care of everything here, correct versus if you may have 5 average molecules that may also take care of everything versus if you have a disaster in all 30 then it is all worthless, so I am just trying to get a sense on how do you as a business owner take this call?

Saharsh Davuluri: The two questions that you asked, the first question was that when we look at our pipeline for different phases, would that pipeline also be in the ratio that I just mentioned where majority being US followed by Japan and Europe. I think the answer would be broadly yes, a bit part of our clinical and commercial pipeline in terms of numbers would be from US company and then followed by Japan and Europe as well. With regards to the quantification part, I think it is a difficult question to answer because I can only just give a range, the smallest molecule in terms of our commercial pipeline may be $2 million and the largest could be in excess of $20 million, so this is the whole range of opportunities out there and because these are new drugs and unless we see how they perform, we can’t be sure wether they could be anywhere in that range or go beyond this range also.

Kunal: If you have done any sort of past analysis on linking this to your client profile, have you seen like clients with fewer drugs or bigger bets kind of clients have better odds of success or is it just doesn’t matter much, for example, in Japan if you are working across the spectrum of sizes, the larger ones have better odds of success and so on and so forth, how we make a call on, they should worth doing for 50 lakhs for eventually the potential may be x how do we do that?

Sucheth Davuluri: There is really no such thing, Kunal because the way we look at that the molecules that go from Phase-1, Phase-2, Phase-3 to commercialization, there is always a percentage and it is always a statistic. Now, no company knows whether their molecule will go through or not because it is dependent on a lot of factors, so the way we look at it is we try to maximize the number of programs we have in Phase-1, Phase-2, Phase-3 molecules because we know that the more number of programs we have from US, Japan or Europe the higher the number of programs that will click and contribute to the growth, so we dispassionately look at maximizing the quality of our clients, the quality of our programs and then just make sure that we have enough projects to ensure our future growth but we are not in a position to look at a specific customer or a specific molecule and try to make a determination whether one will be more successful than the other.

Moderator: Thank you. Next question is from the line of Ravi Sundaram from Sundaram Family Investment. Please go ahead.

Ravi Sundaram: I just have one clarification. Sir, we had some tax provision about Q4, I understand through your opening remarks, is there any other provision that we should expect part of tax for FY21?

Sucheth Davuluri: I think there is nothing which we can expect to have in FY21, so this is one, unless and until the government comes up with some kind of new provision or new tax law which we can evaluate.

Moderator: Thank you. Next question is from the line of Ravi Sundar from Sundar Family Investment. Please go ahead.

Ravi Sundar: My question was, many companies are moving away from China, so this China substitution team will benefit our API segment or not?

Saharsh Davuluri: So you want to know whether the China sentiment will benefit Neuland or not?

Ravi Sundar: Yes sir, for the API segment.

Saharsh Davuluri: So I think at a macro level we would believe so because if the industry acts on the sentiment, then it would mean that they would look at Indian companies as more suitable partners for API and it does happen that lot of our competitors are from China and they would kind of be out of the mix for future business. It is too early for us to say whether the industry is acting on the sentiment or not but if it does then definitely it is a good opportunity for Indian companies and Neuland as well.

Moderator: Thank you. We take the last question from the line of Saket Kapoor, Individual Investor. Please go ahead.

Saket Kapoor: The question is on the R&D investments for FY20 and FY21, both on the capital and revenue, so FY19 was 21.5 crores, what have we done for FY20 and if you could just give some sort of ballpark for FY21 as well, please?

Bharadwaj Gollapudi: Saket, for FY20 I think we have around 17.5 crores towards R&D expenditure on the revenue side and around 3.5 crores on the CAPEX side.

Saharsh Davuluri: For FY21, as a percentage of sales, we intent to keep it at similar levels because as an organization we are still focusing on R&D because R&D is what really going to drive our future growth. In terms of capital expenditure, we don't have the earmarked number for R&D CAPEX but we will check and see if we can get back to you later on that.

Saket Kapoor: And how many scientists have we got currently? Is that still ballpark 270 odd?

Saharsh Davuluri: Yes, that is the ballpark number we have.

Moderator: Thank you. Ladies and gentlemen that was the last question for today. I would now like to hand the conference back to the management for closing comments.

Sucheth Davuluri: Thanks everyone for being on the call. I think there were lot of good questions today about our peptide, its strategy, when will the CMS business contribute to one third of our revenues, questions around the CAPEX plan as well as all the molecules in our pipeline whether that is preclinical Phase-1, Phase-2 or Phase-3 as well as lot of questions around when we will operationalize Unit III. So I think good questions overall and hope we were able to answer all of them to your satisfaction. If you still have any questions which you feel have not been answered completely, you can always get in touch with us and we will be happy to provide those answers. I think I would like to reiterate Neuland's strategy as a pure play API supplier focused on specialty APIs, prime APIs as well as the contract manufacturing business. I think in any point we don't intent to deemphasize any of these three segments and I think our growth and strategy is to grow all of these three segments with heavy focus on our contract manufacturing business to drive our future growth. I think our customers have recognized that. I think our relationships, the growth in the topline business as well as the margins reflect and validate our strategy and the tremendous amount of trust that our customers place in us. Again, thanks for all the trust that you placed in us as well and with that I want to thank Diwakar, the organizers and everyone that has made this call happen. Thank you.

Moderator: Thank you very much. On behalf of Neuland Laboratories Limited, we conclude today's conference. Thank you for joining, you may now disconnect your lines.