"Neuland Laboratories Limited Q2 FY21 Earnings Conference Call"

November 03, 2020

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Moderator: Ladies and gentlemen, good day and welcome to the Q2 FY21 Earnings Conference Call of Neuland Laboratories Limited. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' and then '0' on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Diwakar Pingle from Christensen IR. Thank you and over to you, sir.

Diwakar Pingle: Thanks, Margreth. Good afternoon and good evening friends. Welcome to the Q2 FY21 earnings call of Neuland Laboratories Limited. To take us to the results and answer your questions today, we have with us top management from Neuland, represented by Sucheth Davuluri - Vice Chairman and CEO; Saharsh Davuluri - Vice Chairman and Managing Director and Deepak Gupta - CFO.

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

Before we start, I would like to remind you that everything that is said in this call which reflect any outlook for the future or which can be constitute as a forward-looking statement must be viewed in conjunction of 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 in the website.

With that said, I will hand over the floor to Saharsh who will give the highlights of quarter gone past. Saharsh?

Saharsh Davuluri: Good evening friends. I thank you for joining this call. Since we still seem to be in the midst of the pandemic, I do hope you and your family members are doing well and wish you the very best in coping with the current situation. As in the previous quarters, I will be speaking for a few minutes on the overall performance and touch upon the drivers of the business, post which we will open the call for Q&A. We had shared the detailed presentation that Diwakar was referring to and it contains all the individual numbers and the same is also posted on our website and the exchanges. So let me give you a short summary of the quarterly performance.

We are very pleased that the performance has returned in another record quarter in terms of revenues at Rs. 242 crores which amounts to 29.6% growth on an annual basis. The GDS and the CMS segments have both contributed to the growth this quarter and we are confident that we will continue the momentum through the end of this fiscal. The long-term visibility for the growth from both the segments looks positive and this has been further aided by the revenue generation from Unit-3, which has been successfully commercialized at the end of second quarter, 2021.

EBITDA at Rs. 41.4 crores is again the highest ever with margins improving to 17.1%. The increase in EBITDA margin is a combination of better operating leverage and improved business mix. The prime segment performed well this quarter and we expect the trend to continue in the near term. The growth was led by Levetiracetam along with the continued growth of Mirtazapine and Labetalol.

The CMS segment reported a quarterly revenue of Rs.77 crores which was in line with our expectation that CMS will be a key driver for growth. Our baseline projects in CMS continued to perform well and we have seen good progress from some of the projects under development which we expect to commercialize over the short to midterm. I also want to remind everyone that CMS revenues tend to be lumpy, so it would be prudent to look at growth over the long term. As always, we have provided the table showing progression of CMS projects for your reference.

I would also like to use this opportunity to welcome our new CFO, Mr. Deepak Gupta. Deepak brings with him over 22 years of experience with companies like Nestle, Coca-Cola, and Indo-Nissin Foods. With that I request the moderator to open the floor for Q&A.

Moderator: Thank you very much. We will now begin the question and answer session. The first question is from the line of Sudhir Bheda from Consultancy Private Limited. Please go ahead.

Sudhir Bheda: My question is on CAPEX side. I think in the 6 months, we have incurred a capex of 57 crores and as you are saying that Q3 is fully operational, so what would be the further CAPEX going forward, have you done with the CAPEX? That is the number one question and two in the CMS business, we have seen that your margin is improving because overall your percentage of revenue from CMS is increasing, so have you converted small business of some 5-10 crores to 40-50 crores, so is this percentage increase is led by those kind of thing? That is my second question?

Saharsh Davuluri: Thanks for the question Sudhir, so we had indicated in our previous conversations that we expect the CAPEX for this year to be approximately Rs.90 crores. So far, as we have said Rs.57 crores or so has been deployed. We expect our CAPEX plans to be more or less in that line, but considering the opportunities with regards to the growing business, there may be need for additional CAPEX, but at the moment we don’t have any further updates to what we have said previously. With regards to the CMS business, as I had mentioned in my opening remarks, the growth of the CMS business has been driven both by new projects which are those small projects which you mentioned as well as the commercial projects which has been part of our baseline. Going forward, we expect some of these new projects to become commercial and therefore give more sustainable long-term growth and we expect the baseline projects to continue to do well. So it is a combination of both the new projects as well as the existing projects that will drive the future growth of the CMS business.

Sudhir Bheda: Is it fair to believe that still percentage of CMS business will go up going forward in overall business?

Saharsh Davuluri: So as I also indicated, from a long-term perspective, we expect that the CMS business will grow and contribute to a greater share of the revenues; however, there could be volatility because the business itself is lumpy, so it may not manifest in consistent quarter-on-quarter growth, but if you can see this time over a Rs.240 crores revenue, Rs.77 crores has come from CMS, which is almost 30% of the business, so we think this is a reasonable benchmark, but it may not necessarily be exactly this number going forward.

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

Sajal Kapoor: My question is related to the nature of the CDMO or the CRAMs industry. We have both large and micro-sized players, so on one hand they are giants like Thermo Fisher and Lonza and on the other side, we have a large crowd of smaller players. So given this fragmented industry, how is Neuland positioned for future growth, I mean in India we do have capital and labor cost arbitrage, but what about the technical competence and some of the other capabilities that we need to compete globally in this large industry?

Saharsh Davuluri: In the CMS business, your question is, what makes Neuland unique and how do we compare ourselves with some of the other players. Two things I would say in response to that, one, we do have a lot of technical capabilities which differentiate us from a lot of other players in this field. We tend to focus on those technical capabilities. It could be deuterated compounds, peptides, chiral chemistry etc., and there is a long list and I don't want to go into all the detail, but we tend to focus on working with clients who find the need for such capabilities. That is the first point.

Second, we find ourselves to be working more successfully when we work with biotech companies. That has been a model that has proven to be successful for Neuland which means that our sweet spot is working with small to mid size companies who require an end-to-end solution from the CMO rather than working with big pharma who essentially look at CMOs more as task owners and therefore overtime, we built very strong set of relationship with a lot of small to mid-sized biotechs, whether they are in US, Europe or Japan and we build our relationships based on them, but what has been unique about Neuland is that we provide an end-to-end solution which means that when they are filing their new drug application, they can rely on Neuland for not supplying just the API, but the complete technical package which is needed for a successful NDA.

Sajal Kapoor: So may be secondly, it is a related question, but it is a different one. So when we sort of compare Y-o-Y over the last few years for our CDMO or the custom manufacturing performance, both revenues and the pipeline of molecules have grown steadily which is always a healthy indicator, but would request some qualitative inputs from your side, so for example, how innovators and clients from Japan and US view Neuland's capability today versus 5 to 6 years back?

Saharsh Davuluri: We would definitely like to provide more qualitative information, Sajal, I think the data we provide on number of molecules in different stages of clinical development is a quantitative way that shows how our pipeline has been evolving. Besides that we will try to think of other qualitative ways to give you the insight but may be a short off the cuff response would be that we tend to work a lot with US biotech's. We also work a lot with Japanese innovator companies, we do work with big pharma, but that is perhaps not our core competence or not really the sweet spot as I mentioned earlier, but we take your feedback and we will think about other qualitative ways to define the CMS business, so that investors could better understand the business.

Moderator: Thank you. The next question is from the line of Sunil Kothari from Unique Investment. Please go ahead.

Sunil Kothari: Sir, I have only one question, that is over next year or 3, what is the top management priority and focus area where you want to give your personal time, core team, r R&D team, and what is our major strategic focus area where we want to improve,maintain or create an organization which will be growing sustainably for may be next 5-10 years, so if you can just qualitatively talk about something?

Sucheth Davuluri: I think that is a good question Sunil, primarily I would say three areas, I mean there are lot more areas that we focused on, but if I have to talk about the top 3, I think one is definitely ramping up our generic product pipeline as well in terms of the number of products that we are scaling up and the DMF which are coming out. That is definitely a focus area for us. The other focused area really is to get our manufacturing strategy right, because Saharsh was saying in his comments, there is a lot of trust, business and growth in the CMS business. As you already know for our GDS portfolio we are already a market leader on several of those molecules and gaining market share for the remaining of them, so for us it is important as to why these products are manufactured, what will be our capacity, how efficiently are we manufacturing them, so that we protect the margins, gain market share and consolidate our position.

The other area would be purely in terms of people because the performance that you see today is a direct reflection of the hard work which is being done by the entire Neuland team, just not the leaders, but the people in various departments in terms of collaboration, looking at where the problems are and figuring out ways to work together to solve those problems is a direct reflection of our financial performance today and finally we are also looking very closely at digitization as to how we embrace technology, so that we can make faster decisions, more data science, more analytics, so that we become much more agile and nimble organization because as the top management, as the board, we feel that the future belongs to organizations which can be extremely responsive and agile in their decision making as well as our execution. So those would be the top 3 of our areas that we would be spending most of the time.

Moderator: Thank you. The next question is from the line of Suhrid Deorah from Paladin Capital Management. Please go ahead.

Suhrid Deorah: I have two questions, my first question is, could you help us understand what is the split between price and volume growth on the GDS side of the business and how that contributed to revenue and profit growth?

Saharsh Davuluri: What is the other question, Suhrid?

Suhrid Deorah: The second question is related to Unit-3, I wanted to understand what is the capital employed in that unit and what is the revenue potential?

Saharsh Davuluri: Let me answer the first question first. Basically, in terms of price versus volume growth, we would largely say and we have made this comment in the last quarter also, we have seen slight easing of pricing when it comes to generic API pricing across the board, but that doesn't really translate to anything significant, may be somewhere in the low percentage points, may be 3-4% or so, but importantly we see that as a sustainable increase in pricing, but something that we will also have to see depending on how the circumstances given the US elections, the trade conflicts, etc., might pan out, but what is important is the volume growth is what really driven the business. Products like Levetiracetam, Mirtazapine, Labetalol that I mentioned have really driven volumes and that is how the overall business has been moving up as well. Maybe I will just ask Sucheth if he can just add some thoughts and also may be Sucheth, you can respond to the second question.

Sucheth Davuluri: Like Saharsh was saying, I think our generic drug business has been a combination of volume as well as value especially our baseline business as you know we break up our GDS business into the specialty business as well as our prime APIs, so we have seen that our growth in the prime API exceeded the budget by about 12 or 15% which means that we have gained the market share and we have seen an increase in volume. At the same time, we have also seen that our specialty business has performed as per the budget, so between prime and specialty they are really contributing to about 50% of the overall revenues which is a clear indicator that the margin of the GDS business is growing as well. Right now, in terms of the capital employed in Unit-3, I would say we are in the range of about Rs.175 to 180 crores, but obviously that number changes continuously because we continue to invest in that unit as Saharsh was saying, we have commercialized, we have made the commercial shipments for the first time in this quarter from that unit and we will continue to ramp that unit up. In terms of the projected revenues, we are just in the process of finalizing our budget for next year, so we don't have a clear breakup of what will be the revenue projection from Unit-3, but it will be sizable revenue.

Suhrid Deorah: Sir, can I just clarify, I meant what is the maximum revenue potential from that unit, if you could quantify that in terms of an asset turn if that is possible to give?

Saharsh Davuluri: Not at this point, it is definitely a number that we are constantly working on, so we do have projections, but that will also change based on the product mix and how we allocate the CAPEX in line with my earlier comment about our manufacturing strategy for each and every product.

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

Deepak Poddar: Sir, you spoke about lot of areas where we are kind of focusing on and plus this Unit-3 as well which has commenced and which will contribute your revenue, so any sort of growth outlook that if you can share would be helpful?

Saharsh Davuluri: Deepak, as we mentioned previously, we don't give any specific guidance for the business. We have maintained in the past and we have said that, on a long-term basis from this business we should expect a 15 to 20% growth, but something that may not be possible on a quarter-on-quarter or a year-on-year basis, so I would just kind of reiterate that same comment.

Moderator: Thank you. The next question is from the line of Keval Ashar, an Individual Investor. Please go ahead.

Keval Ashar: Sir, I have two questions, the first is, right now, we have three molecules in phase 3, 10 in developmental stage and 6 in commercialization stage, so how many molecules can we expect in commercial stage over next 2 years?

Saharsh Davuluri: The molecules which are currently in the commercialization stage, those are the molecules which are imminent and likely to get into the commercial stage. Typically, these are molecules which will have to go through may be an FDA approval or may be alternate side qualification process. I would say it is hard to be very precise on the timelines because those timelines are not in our control, but I would say may be in the next two years, we would expect at least 3 molecules to get into the commercial pipeline, but that number could vary depending on a lot of circumstances from the FDA perspective or the regulatory agencies.

Keval Ashar: And the second question is, if you can give us idea on average revenue for molecule in the developmental stage and commercialization stage?

Saharsh Davuluri: It is difficult to answer that question because there is a very wide range. You can see from our table we have over 15 molecules, I can tell you that there are some molecules which only contribute Rs.8 crores per year, there are some molecules which contribute may be Rs.50-60 crores per year and we expect some molecules to may be in the future contribute even much higher in that, so there is a very wide range and I think we are hopeful that the growth will be better than what we expect, but we don't want to give any sort of guidance or even we don't want to give you any sort of an assumption at this time because the range is just too wide.

Moderator: Thank you. The next question is from the line of Hasmukh Gala from Finvest Advisors. Please go ahead.

Hasmukh Gala: We have been tracking Neuland for quite some time and the structural changes that has been made in the last few years is really noticeable and appreciable. Sir, we just wanted to know on the macro perspective that what is driving the demand for API intermediates and CMS business and how are we going to modify or tune our strategies to meet those emerging requirements, like one of them was that people shifting away from China and Europe is also going to do lot of things on that? It is the first question and second question was on the peptides, in the last call, you had said that there are a few molecules, they will reach the stage of filing DMF in probably one or two years, so what is the development on that, sir?

Sucheth Davuluri: Good question Hasmukh, I think like I mentioned there are couple of different factors driving this, one is especially what has happened in the last 2 or 3 years where China is increasingly seen as a partner that cannot be trusted and nowadays, the term that trade without trust has become a very common sentence which is attributed to China, I think that is one development. People have also realized that API is at the heart of the pharmaceutical industry, but at the same time, not everybody can succeed in the API game because at the end of the day, it is a complex industry, it is complex in terms of process development, scale up, a large scale commercial manufacturing.

As Saharsh was alluding to one of the questions earlier, Neuland's place in the pharmaceutical industry is able to take a technology which is underdeveloped, I would say which is nascent and help to take the technology through the clinical pipeline all the way to commercial manufacturing including the product life cycle and pass the generic launch as well and that is why Neuland has been increasingly successful and that is why our customers trust us in terms of being able to take a molecule which is in the early stages of development, all the way to commercial launch and beyond, so that they have a partner that they can trust with.

So the other thing I would also like to add is that Neuland has never really competed only based on cost, though there might be a cost arbitrage for certain molecules being manufactured in India. We have always focused on technology and our technical capabilities for the molecules and the projects that we bid on. So I think our strategy going forward is to make sure that we have a good manufacturing strategy that will give us the right capacity, right cost structure, have a supply chain strategy which brings our supply chain much closer to home, where the supply chain is much shorter.

Even now less than 25% of our supplies come from China, by the end of this year, we expect that less than 10% will come from China, so we are completely insulated and we were actually spending most of our rupees and dollars here in India and other parts of the world. We will continue to invest in manufacturing as well as technology, so that we continue to be more efficient and continue to build on those relationships that we have with our generic customers in terms of the number of molecules that they buy from us as well as the contract manufacturing customers, so that they can come to us with their future projects as well as increase the share of product that they buy from us, so that is kind of what Neuland is trying to do in a nutshell.

Hasmukh Gala: Sir, as majority of our revenue is coming from Europe right now and Europe is going to scale up the API manufacturing facility for some of the API, so how is that going to affect our business in future?

Saharsh Davuluri: Well, Europe has been trying to scale up its APIs for the last 20 years Hasmukh. I have heard this storyline again and again. Europe has been having conferences at least 3 or 4 times a year with its API manufacturers as to how they can gain their position that they had in the 70s and 80s in terms of API suppliers. So, I would not undermine Europe's effort. What I would say is that not every company can manufacture every molecule, I think Europe could become a leader in certain molecules based on where they invest their dollars and where they focus, but I feel that Indian API players such as Neuland are very strong and API players such as us who has been around for a while who have the depth, who understands what it takes to manufacture API reliably in compliance with the good track record with the FDA and a good cost structure and the future clear manufacturing strategy will succeed and that will happen independent of whether you are in Europe, India or China.

Moderator: Thank you. The next question is from the line of Raj Rishi, an Individual Investor. Please go ahead.

Raj Rishi: Sir, any plans to raise resources like equity or debt?

Saharsh Davuluri: No plans at the moment, Raj.

Raj Rishi: Just a perspective that right now the market is pretty willing to back company like Neuland, so don’t you think that should also be a reason to raise resources say on the equity front since the opportunity is so large?

Saharsh Davuluri: I think as we had explained in some of the previous comments, we have fairly robust business plan in front of us. We have recently capitalize Unit-3, we have created lot of capacity over there, we have plans to deploy some more capital into Unit-3 to make sure that it fulfills the needs of the business for the next couple of years as well and for all this, the capital has been already planned for, the balance sheet, the ratios, the debt arrangement that we have made plans for seem reasonably adequate. So, at this point we don’t see a need for infusing equity into the company, but as the needs of the organization might evolve, we will definitely look at it. We understand your point of view that the markets are favorable for raising capital at this time, but we don’t see the need for raising capital, not just immediately but for the near to midterm as well.

Raj Rishi: And sir, any plans for inorganic growth? Any acquisition targets you are looking at or something which you can share with us?

Saharsh Davuluri: Nothing that we can share, Raj.

Moderator: Thank you. The next question is from the line of Jay Vora, an Individual Investor. Please go ahead.

Jay Vora: So I was going through the presentation and I could see that generally the second quarter is good, so is there any seasonality factor over there and in current quarter as well, the revenue from the CMS business and specially in the commercial, it was very good, so was there any one-off or bulk order or something like that and if that is not the case, then can this quarter will be taken as the base for the coming quarters?

Saharsh Davuluri: In the API business, I think what we have seen over the last several years, there does tend to be some kind of trends. We have seen that the third quarter of the year tends to be a year where revenues could possibly dip, although we don't want to comment anything about what is coming up. That is also because it is the fourth quarter for most of our customers based out of Europe and US. Typically, the rest of the quarters, we don't really see any discerning trend, so I am not sure if I would agree that second quarters tend to be strong.

Other than that, I would also recap what I have said in the opening remarks, I think the CMS business we are very pleased with what we have done this quarter, it is a combination of baseline business which is recurring commercial business as well as new business and therefore it is not necessarily a onetime business, but at the same time the CMS business does tend to be lumpy, so there could be certain periods where we see higher revenue coming in, but having said that I think from medium to a long-term perspective, we think this quarter's performance is a very reasonable base, but again I would add the caveat that being in the API space, we do deal with a lot of uncertainties, so we don't want to sound extremely confident when we say that the base will remain this way and there will be no uncertainties going forward. So, I just want to add that caveat as well.

Jay Vora: And my second question is that barring these three quarters,, almost 4-5 quarters back, we were adding somewhere around 5 projects every quarter for the CMS business, but that has a bit slowed down to 2 project per quarter, so is there specific reason to this?

Saharsh Davuluri: I think that is a very good question and I think the reason for that is as we have seen the CMS business mature, we have started to focus little bit more on late stage opportunities. We do still get a lot of early stage opportunities, but both from an executive point of view as well as business development point of view the teams have been focused more on late life cycle projects and as in the case of any serious contract manufacturing organization, the idea is to **take** the projects which get to commercialization as quickly as possible, so therefore it is a positive indicator that we are adding more projects in the late stage of the pipeline. Having said that, we do expect early stage projects to get added to our pipeline as well, so there is no real strategy of not adding early stage projects, we could see the trend changing, but your observation for the last few quarters is absolutely right.

Moderator: Thank you. The next question is from the line of Aditya Khemka from InCred AMC. Please go ahead.

Aditya Khemka: Sir, couple of questions on your revenue side. So I noticed we have CMS and GDS business and you commented that on the CMS side, we work with SMID companies, biotech companies in the US and GDS obviously is generic drug and your geographical split when you say 48% of revenues come from end-market of Europe, would it be fair to assume that lion share of our GDS revenues come from the European market and the lion share of our CMS revenues comes from the US end market, is that fair assumption?

Saharsh Davuluri: I think for the GDS business, absolutely right, I think a large part of the business comes from Europe followed by the other market. I think for the CMS, I would just kind of agree with you, but also state as a caution that the CMS business is still an evolving business and the geographic contributions could tend to vary as different projects scale up. They could also vary quarter to quarter because you could have European customers place more orders and therefore a particular quarter's number or a particular financial year's numbers may be skewed geographically towards one region, but if I have to say today, in terms of CMS, our largest market is the US and Japan and Europe are following that, but that could also change depending on how different projects scale up.

Aditya Khemka: So the reason I asked this question was on your commentary on GDS, you said that there was some levy on API pricing that you could experience in the past quarters, I am just a little surprised because the European markets itself are going through a very difficult time when it comes to their financial positioning and the austerity that these governments are practicing. To add to that, COVID situation has been probably worst in the European region compared to other parts of the world and therefore prescription volumes should ideally be also soft versus our normal European prescription trend in the earlier periods, so how is it that in this environment we are able to; first take some price increase in our products and second we are able to sell enough volume, so are we like gaining market share from 20 to 40% and our competitors are losing that much market share and if so, then why are they losing so much market share, is it disruption of production at their end or is it that we have just edged them out on a cost competitive basis?

Sucheth Davuluri: It is two reasons Aditya, one is that what you said is very molecule dependence, definitely molecules especially Broad-spectrum antibiotics, Semi-synthetic APIs which are under lot of pressure, but we don’t sell any of those molecules. Lot of our specialty molecule revenue has also come from Europe where there is less pricing pressure. The second reason is historically, Europe is also a dependent on buying a lot of raw material from China and because of what happened with China and several CEPs also being cancelled, we are seeing lot of opportunities come to us from China as well and since we have historically had a strong position in those molecules we are gaining that market share. So that is specific to what is happening to Neuland in Europe.

Aditya Khemka: I will just have one more question, when I see your operating margins, your EBITDA margins, it is 17% and if I look at your CMS and GDS businesses, would it be fair to assume that the CMS business margins significantly outpace your GDS margins and if that assumption is correct, why are our margin so low in the GDS business?

Saharsh Davuluri: We have said this in the past Aditya, our margins actually are very product dependent, it is not really segment dependent, yes we do state that the CMS margins are relatively higher especially if you compare it with say the prime segment of the GDS business, but there are products with GDS who have margins which are far higher than some of our CMS products, but the range is quite diverse and therefore it is hard to say. I think on an overall basis, we believe that our products are differentiated as Sucheth was also explaining. We don’t have too many commodity type GDS products in our portfolio and the EBITDA margin improvement that you are seeing is actually a result of two things, one, the business volumes are growing and that is improving operating leverage, second the quality of the product mix, both within GDS and CMS is also elevating the margin profile, so that is the reason why you are seeing an overall improvement in the margin profile.

Aditya Khemka: Sir, sorry, I need a clarification there, would it be right to say that your capacities within CMS and GDS are non-fungible, they can't substitute each other?

Sucheth Davuluri: Let us just back up a little Aditya, so to answer your question directly, absolutely not the capacities are fungible, because Saharsh was saying that we are an API company and when we look at our analysis internally, we do a product by product analysis and wherever we feel that the margins are under pressure, we talk about what steps we need to take as an organization to increase those margins. So the only other point I would add towards Saharsh has said is that part of the margin expansion has also happened because of our continuous efforts to reduce cost and what you also have to take into consideration is that in our capital employed at Unit-3 is about Rs.185 crores, but we haven't reached any operating leverage there and as Unit-3 continues to get commercialize, we expect that the margins will continue to improve as well. So we have to be able to look at the whole picture, it is not very segment dependent.

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

Cyndrella Carvalho: Management, if you could help me understand, I have 2-3 broad questions, on the generic side of our business and the CRAMS or the CDMO side of our business, so if you could help me understand what are the recent opportunities due to these Chinese disruption that have come through our view and the other aspects here I would like to understand is, how well prepared are we to grab this opportunity? The other question that I have is, if we look at, what you just now said about the utilization of Unit-3, when do you expect that in terms of timeline to reach peak utilization?

Saharsh Davuluri: I think with regards to the question about the opportunities from China, Cyndrella I think that question was already answered in detail by Sucheth, a few minutes ago, so I don't want to get into that in the interest of time, could you remind me what your second question was?

Cyndrella Carvalho: About the Unit-3 capacity utilization reaching its peak? By when can we expect, sir?

Saharsh Davuluri: I think that question was also answered in a different way, but I will still respond to that. I think Unit-3 as we have explained is still in the process of getting capitalized. Today, the utilization of the plant is at a very low level. We mentioned that we just started commercialization this quarter. Going forward, we have plans to scale up both CMS as well as GDS molecules from Unit-3, but quantum of how much that unit can generate in terms of revenue is something that is an evolving number and it is hard for us to share because it really depends on the product mix and the nature of the molecules that we are scaling up over there, but we do believe that it will fulfill the needs of the organization for the next 2 to 3 years at least and therefore we have plans of deploying more capital into it by placing additional production blocks, debottlenecking some of the existing production blocks to make sure that it meets FY22-23 requirements.

Cyndrella Carvalho: Just if you could refresh my memory on how much have we invested so far in Unit-3?

Saharsh Davuluri: We have not disclosed that number Cyndrella, the capital employed is Rs.185 crores.

Moderator: Thank you. The next question is from the line of Nikhil Upadhyay from SIMPL. Please go ahead.

Nikhil Upadhyay: My question is on the GDS part of the portfolio and along with the prime end, earlier in the commentary you mentioned that most of the growth was volume driven, because the prices were down some 3-4%, I just want to understand like on the volume side sir, in the product say, of our top 10 products would you say our market share has considerably increased and what would that market share be now and in terms of when we say that this Chinese players have exited and everything, do you see any sense that the new entries could be coming or new players could come up from other regions or in India or, if you can just share your thoughts on this GDS part?

Saharsh Davuluri: I will just share some broad thoughts because every product is different, so it might be difficult to give detailed response on it, but I think in terms of just want to clarify very quickly that I did say that GDS business grew based on volumes and also we got certain price improvements, not price decline, so I just want to clarify that and I did mention that it is not a very significant price increase, may be around 3-4% kind of an increase, but what is important is that the growth is driven by volumes which is a very positive development. The growth has been across various products. We did mention highlight in our opening remarks that Levetiracetam, Labetalol, Mirtazapine, these are all products which have been part of our prime portfolio for several years, but they have been continuing to grow. I think in terms of our market share, the market share numbers are again quite varied. There are products where we have 75-77% of world market share, there are products where we have may be less than 10% of market share.

Across the top 10 products, I would say, perhaps may be 7 or 8 products I am speaking intuitively our market share has been kind of moving up, again different percentage points. Our focus with our sales team as well as our operations team has been to try to consolidate our market share for the products where we are already present in. The fact that we are a pure play API company also boards well with our customers who are mostly generic companies for the GDS business to help them build confidence with them. We are also seeing a trend where fully integrated pharmaceutical companies are also now kind of looking at qualifying Neuland as API source in substitution for their in-house API which also has created a lot of opportunities across multiple products.

So all in all, I think on the GDS front, we are seeing good opportunities in terms of volume share, we are not paying that much pricing pressure, although I would kind of remain cautious on how long that situation would remain and I think in terms of market share we are seeing a reasonable increase in market share across our top 10 products and as Sucheth also had indicated earlier by focusing on cost reductions we are trying to make sure that our position remains strong. I think with regards to China, Sucheth, you want to comment anything what is the impact of the Chinese trade issues and all with regards to our business?

Sucheth Davuluri: Yes Nikhil, the only thing I would like to add is that we don't want to create the impression that all our customers are potential customers are dropping the Chinese like hot potatoes, it just wouldn't be true. What happening is that certain products where China was a leader was the primary source where they took away our market share or eroded our margins, so products that we were established, we have seen some of that business come back. Again, I think our strategic acquisition of Unit-3 was very well timed and what are the CAPEX that we had to make a decision on, in fact, we made that decision right after the lockdown because of the pandemic. So we took a very conscious choice that we should be prepared for any opportunity that comes our way and , both the acquisition of Unit-3 and that decision to increase the amount of capital employed in Unit-3 were well timed because we are seeing the benefits of that now and we will continue to see that in the future.

Moderator: Thank you. We will take one last question which is from the line of Shreyas from Fidelity. Please go ahead.

Shreyas: I had two quick questions. One with regard to raw material cost in terms of the normalizing over the last year or so, if that trends that we see continuing and second with regard to capacity utilization across the board, if you can add some color on these two things, that will be great? Thank you.

Saharsh Davuluri: I am sorry, just want to clarify the question because the voice was not very clear, your first question was with regards to raw material sourcing?

Shreyas: Yes, raw material sourcing and cost in terms of utilization or in terms of inflation or in terms of deflation of raw material cost, how are we seeing that panning out?

Saharsh Davuluri: Okay raw material cost and your second question is about capacity utilization?

Shreyas: Yes sir, across the board, if you can share some color on that?

Saharsh Davuluri: I think you may be familiar with situation, I think 2 years ago, we faced a lot of challenges with regards to raw materials that we were particularly buying out of China and that resulted in a huge spike in our raw material cost and it did impact our profit margin for the year, again it was FY19, but I think as Sucheth had explained elaborately in the call earlier today, we made a steady progress on two fronts, one is cost reduction of all our products, so our process R&D teams tried to optimize the process so that we are improving efficiency and reducing our cost. Second, we have also steadily looked at de-risking ourselves from China by either trying to find alternate sources, either in India or elsewhere. I think as a result of those two actions today, from a supply chain risk point of view, we seem fairly confident much better than where we were earlier. In terms of price volatility, we have not seen any kind of volatility in the last at least 9 to 12 months.

We believe we have better controls in place now to control any kind of volatility that may come out, but having said that we tend to remain cautious, so therefore we would maintain that cautious optimism going forward and as you can see I think for this financial year we are reasonably confident that our raw material cost will stay in line and the gross margins that we have seen so far will continue to hold. I think with regards to capacity utilization, I broadly it may be around 65%, it would vary from production block to block, it would also vary from production side to side. This is an average number across the board. Also, it is a very dynamic number. As we explained, we have already deployed 57 crores of capital in the first two quarters. We expect to deploy some more and a lot of the capital is going into creating more capacity either by additional equipment or debottlenecking, so therefore our goal is to keep our capacity utilization less than 75% at any point of time, so that we also have the headroom to manage some of the uncertainties and volatilities of the business.

Moderator: Thank you. Ladies and gentlemen, due to time constraint, that was the last question. I now hand the conference over to the management for closing comments.

Sucheth Davuluri: Once again, we thank all of you for your interest in Neuland as well as the questions. We thought that all of the questions were very good and very pertinent to the business. I think I had mentioned during the call our CAPEX program for this year is about Rs.90 crores, but we definitely expect to push it up given the opportunity that we see in the market. The last thing we don't want to do miss opportunities which are being created by the current situation as well. Obviously, the CAPEX decisions we make are based on our operating cash flows and free cash flow taking the overall balance sheet ratios into consideration, so that we can continue to maintain the strong liquidity that we have in the system and not take on any undue risk. Obviously, our place in the CMS business is with companies that have molecules in early stage that need a partner that they can trust, a partner that can take a molecule from early stages of development, all the way through commercialization and manage it through its life cycle. That is where we have got in the maximum traction and that is where we intend to build and consolidate our strategy.

I think Unit-3 was a very timely acquisition. We have commercialized it. We continue to invest tenure and we will see that Unit-3 contributes more and more to the topline of the business both for our contract manufacturing molecules as well as gaining market share for our GDS molecules.

Finally, I think the China opportunity is there, those in terms of being able to source from China, but not completely depending on them, so I want to clarify that though our dependence on China is completely reducing, it doesn't mean that we want to buy less and less from China. At the end of the day, we have to make sure that we are being competitive and we are partnering with companies and countries that will ensure that we are able to maintain and grow our market share. However, given what is happening in China, we have taken steps to make sure that we are not exposed and we are not putting Neuland at undue risk because of our dependence on China. So I think that is kind of what was discussed in today's call and we thank you again for this consolidated interest in Neuland, also the organizers for this call. Thank you very much.

Moderator: Thank you. On behalf of Neuland Laboratories Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.