"Piramal Pharma Limited Q2 FY '24 Earnings Conference Call"

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MANAGEMENT: **MS. NANDINI PIRAMAL – CHAIRPERSON, PIRAMAL PHARMA LIMITED**
MR. PETER DEYOUNG – CHIEF EXECUTIVE OFFICER, GLOBAL PHARMA, PIRAMAL PHARMA LIMITED
MR. VIVEK VALSARAJ – CHIEF FINANCIAL OFFICER, PIRAMAL PHARMA LIMITED
MR. GAGAN BORANA – INVESTOR RELATIONS, PIRAMAL PHARMA LIMITED

Moderator: Ladies and gentlemen, good day and welcome to Piramal Pharma Limited Q2 FY'24 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 this conference call, please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Gagan Borana from Piramal Pharma. Thank you and over to you, sir.

Gagan Borana: Thank you, Neerav. Good morning, everyone. I welcome you all to our Post-Results Earnings Conference Call to discuss our Q2 FY '24 Results. Our Results Materials have been uploaded on our website and you may like to download and refer to them during our discussion.

The discussion today may include some forward-looking statements, and these must be viewed in conjunction with the risk that our business faces.

On the call today, we have with us Ms. Nandini Piramal – Chairperson, Piramal Pharma Limited; Mr. Peter DeYoung – CEO of Global Pharma; and Mr. Vivek Valsaraj – CFO of our Company.

With that, I would like to hand over the call to Ms. Nandini Piramal to share her initial thoughts.

Nandini Piramal: Good day everyone and thank you for joining us today for our Post-Results Q2 and H1 FY '24 Earnings Call.

QUARTER'S PERFORMANCE:

We have delivered a healthy performance in the First Half of the Financial Year with a 14% revenue growth accompanied by over 300 basis points improvement in EBITDA margin.

It is also satisfying to note that this performance has been broad-based with our CDMO business returning to a mid-teen growth and the CHG business and India Consumer business maintaining their steady growth.

Healthy revenue growth along with our cost optimization initiatives are helping us deliver better profit margins as a large part of our costs are in the CDMO business is fixed in nature.

Historically, our H2 has been better than H1 both in terms OF Revenue and profitability, and we expect the same trend to continue with a strong H2, more specifically Q4. We expect a high-teen Y-o-Y revenue growth and material improvement in EBITDA margins in H2 versus last year's H2 and deliver a robust performance for the financial year.

During the quarter, we also successfully completed our rights issue with 128% subscription. A significant part of the proceeds from this right issue have already been utilized to pay down debt. As a result, our net debt is now down to Rs. 3,823 crores, which is a reduction of Rs. 958 crores compared to March 2023. Going forward, we will be working towards a further reduction in our net debt through our internal accruals.

ON THE ESG FRONT:

We released our sustainability report for FY '23, which details our progress on integrating sustainability in our operations. Sustainability for us is more than just being compliant with regulatory norms and standards. We are working diligently to minimize our resource consumption, conserve biodiversity, provide a safe workplace for all employees, deliver quality products and services, promote diversity and inclusion in our workforce, and enhance the quality of life in the communities around us.

We have taken a target to reduce our greenhouse gas emissions by 42% by FY '30 compared to FY '22, which is in accordance with the 1.5-degree trajectory suggested by SBTI. We have also taken targets in other areas such as waste management, water stewardship, gender diversity, health and safety, automation, and digitization, and customer satisfaction on which we are progressing well.

During FY '23, we increase the share of renewable energy in our operations, save fresh water by promoting recycling and reuse, planting more trees across our manufacturing sites to conserve biodiversity. We increased women participation in our workforce, had zero fatalities, and ensured a best-in-class quality record with 36 successful regulatory inspections and over 100 customer audits.

BUSINESS SPECIFIC HIGHLIGHTS:

CDMO BUSINESS:

In our CDMO business, we witnessed good momentum and order inflows in quarter 2 FY '24 as well. The development and more specifically, new commercial orders received in H1 FY '24 are higher by over 40% compared to orders received in H1 FY '23. The order inflows over the last three quarters have helped improve the revenue visibility growth for FY '24.

Further, the recent order inflows have a higher quotient of innovation related work with a good proportion of commercial orders for on-patent molecules. Our CDMO revenues from innovation-related work have grown at 17% CAGR in the last four years and now account for about 45% of our CDMO revenues compared to 35% in FY '19.

Similarly, our CDMO revenues from differentiated offerings like ADC, peptides, high potent API, sterile injectables and development of on-patent API have grown at 19% CAGR between FY '21 to FY '23.

GENERIC API BUSINESS:

Our generic API business, which has a soft demand in FY '23, is also seeing a year-on-year pickup in demand. Given the pickup in the CDMO business, we have also seen an improvement in EBITDA margin driven by revenue growth, favorable revenue mix, normalization of raw material costs, and cost optimization initiatives.

We are also pleased to note that we earned our first revenue milestone of a newly expanded Grangemouth facility in quarter 2 FY '24. Post the expansion, we now have five suites compared to three earlier. The expansion strengthens our presence in the antibody drug conjugate market.

REGULATORY COMPLIANCE:

In terms of regulatory compliance, five of our CDMO facilities, which contribute to about half our CDMO revenues, have successfully completed US FDA inspections in the last 12 months.

COMPLEX HOSPITAL GENERICS BUSINESS:

Moving on to our complex hospital generics business, our inhaled anesthesia portfolio continues to deliver healthy performance, mainly led by strong demand for Sevoflurane. We maintain our leading position in the US Sevoflurane market with a market share of about 44% compared to 30% about 3 years back.

We are also progressing well on our capacity expansion plans for inhalation anesthesia to meet global demands. We are setting up a manufacturing line for Sevoflurane in our Digwal plant to cater to the growing demands of emerging markets. We are also expanding our Dahej plant to increase our key starting material capacities and to have a higher degree of vertical integration.

During the quarter, our inhalation anesthesia manufacturing facility at Bethlehem underwent an US FDA inspection. We received two observations, both related to system improvements and none to data Integrity. We are currently addressing these observations and look forwarding to closing them at the earliest to ensure full compliance with the US FDA, the GMP standards.

INTRATHECAL SEGMENT:

In intrathecal Segment, we continue to command a leading market share in the US. Our brand Gablofen continues to be the number one ranking, Baclofen prefilled syringe and vial brand in the U.S. with a market share of 76%

INJECTABLE PAIN MANAGEMENT SEGMENT:

In the injectable pain management segment, our brand Fentanyl is the number one ranking brand in its representative markets of Japan, South Africa and Indonesia.

While we focus on further strengthening our positioning in our existing product portfolio, we are also building a pipeline of 28 injectable products which are in different stages of development. The addressable market size of these products is about $2 billion.

INDIA CONSUMER HEALTHCARE BUSINESS:

Our ICH business delivered a year-on-year growth of 13% in the H1 FY '24 aided by growth in our power brands and new product launches.

We continue to invest in media and trade spends to drive growth in our power brands. Promotional spends during H1 FY '24 was 14% of our India Consumer Healthcare revenue. Our power brand grew 14% during Quarter 2 FY '24 and contributed 42% of our total consumer healthcare sales.

Our key brands such as Littles and Lacto Calamine grew at about 24% and 19% respectively in quarter 2 FY 2024.

We have also increased the pace of new product introduction in the new recent years. Over the last three years, we have launched 100 plus new products in the market with a healthy success rate. During Quarter 2 FY '24 also, we launched seven new products and two new SKUs. New products launched in the last 24 months contribute to about 16% of our consumer business.

Our sales and our e-commerce platforms are growing well. We now have a presence across 20 e-commerce platforms and our own direct-to-consumer website Wellify.in, which is seeing an encouraging response. During the quarter, our e-commerce sales grew at about 34% year-on-year and contributed 16% of ICH revenue.

TO SUMMARIZE:

I would like to say that we have delivered a healthy performance in the first half of the financial year with broad base revenue growth and Y-o-Y with margin expansion. We expect to better this in the second half of the financial year. Historically, our H2 has been better than H1, both in terms of revenue and profitability. We expect a similar trend to play out this financial year as well.

Our CDMO business has returned to mid-teen revenue growth on the back of continued order inflows, especially for a differentiated offering and innovation-related work. Our inhaled anesthesia portfolio is also seeing a healthy demand.

Further, our India Consumer Healthcare business is delivering a good growth driven by our power brands. We continue to maintain our best-in-class quality track record and are taking multiple initiatives in the area of ESG. We hope to continue our momentum in H2 FY '24 and end the financial year on a strong note.

With this, I would like to open the floor for the Q&A.

Moderator: Thank you very much. We will now begin the question-and-answer session. The first question is from the line of Aditya from AJ Investments. Please go ahead.

Aditya Javar: Ma'am, I have a few questions. One is related to margins for this quarter, right. We have done 14% margin, but if I see it is mainly coming from the changing inventory. So, is it kind of one-off or is it sustainable? That is my first question.

And the second question is related to how much I have seen that you have mentioned the innovative pipeline is picking up. So, for this, what is our target to achieve in innovative CDMO?

And the third question is, if I see Complex Hospital Generics, there is a drop on quarter-on-quarter. So, are we losing the momentum here or are we still good to grow 15% to 20% on Complex Hospital Generics? These are my three questions.

Vivek Valsaraj: So, with respect to the margins, there are actually three components to it. One of them, as you pointed out, is related to the inventory. So, you will see that the other expenses line is actually higher in terms of growth and the corresponding credit for that resides in the inventory that has no impact on the overall EBITDA margin.

The second is last year we had higher than normal provisions for inventory in one of our businesses.

And the third is there is also the benefit of various cost optimization and operational excellence initiatives, which are helping the overall operating margins, and the gross margin in particular. So, all the three are actually driving the overall margin enhancement.

Nandini Piramal: And is it sustainable?

Vivek Valsaraj: And a large part of this, of course, is sustainable. Only to the extent of inventory, this will get reversed off in quarter 3 and quarter 4 as we sell more, but the others are all sustainable. Moving on to your next question on Complex Hospital Generics, actually, if you look at it, you should

look more at the H1 growth. There is a bit of lumpiness in the sales last year, especially between quarter 1 and quarter 2, but on a H1 basis the growth is 13%, which is reasonably a good growth for the business.

Nandini Piramal: And in terms of balance between innovation work and kind of generic work, I think we do see that that trend picking up over the next few years, and we would like to continue to see that. I don't think we have a particular target in mind, but we believe that the innovation work and specialized work will help promote healthier margins going forward.

Aditya Javar: So, the current quarter margins, of 14%, it is sustainable, and for the second half, what are the expected margins?

Nandini Piramal: I think we have expected, we will see revenue growth in the high teens going forward, and we will see our EBITDA margin actually improve considerably as we get operating leverage. Historically, our H2 revenues and EBITDA margins have been obviously much healthier than H1, and we expect to see that same trend continue.

Aditya Javar: So, what would be the margins? Ballpark figure? It will be 16% to 18% or more than that?

Vivek Valsaraj: So, Aditya, we are not calling out a margin. I think you will be able to make that guess. As we mentioned that we will have high teens growth in H2 in revenue and that will lead to operational leverage, and yes, definitely margins will be better than what they are in H1.

Aditya Javar: So, basically, the revenue guidance is 15% to 18% whole year and margins would be up 15%, correct?

Vivek Valsaraj: So, we are not calling out specific number on the margin. We still say that it is going to be high teen growth, and accordingly, the margins will improve materially Y-o-Y in H2.

Moderator: Thank you. Next question is from the line of Vivek from DSP Mutual Fund. Please go ahead.

Vivek Ramakrishnan: My question was on the overall environment. Last year the narrative seemed to be more around biotech companies facing trouble and slowdown in the CDMO business, but this year there has been a sharp bounce back. So, could you tell us about the nature of the customers? Are they better funded for bigger customers or how is the industry moving? That's my only question.

Nandini Piramal: So, I think, last year we did have a tough year. I will say that the biotech funding crunch I think still is kind of part of the macro environment. I think what we have seen is that some of our biotech customers were bought by big pharma, and we in a way rebalanced a bit to big pharma. So, overall, I think, if we look at a, we have a healthy mix of customers between biotech and big pharma, and so I think we are doing reasonably well.

And lastly, I think there is funding still if you have proven clinical work. So, especially phase 2, phase 3 things that are in the pipeline are getting funded, and so we expect to see that continue.

Peter DeYoung: I would just add one line, which is that we have seen, we continue to see growth in both emerging bio pharma and large pharma, but we have seen a little bit more growth in the recent period from large pharma for the reasons Nandini mentioned, but we are still obviously targeting both segments.

Moderator: Thank you. Next question is from the line of Ranvir Singh from Nuvama. Please go ahead.

Ranvir Singh: A few clarities. On CDMO side, can you give the split between innovation related revenues and generic API related revenues? That is one. And secondly, if you could give the revenue from the JV during this quarter?

Nandini Piramal: Our innovation related work is about 45% in FY '23 for the entire business. That would include development work, on-patent commercial work, as well as on-patent formulation and discovery work. Our generic business is both formulations and API. Some of it is made directly to order for customers as well as some is owned by us. But I think that balance while we haven't released FY '24 numbers, right now it would be approximately the same.

Vivek Valsaraj: And Ranvir, on your question on the JV revenues, let me just clarify that the JV revenues are actually not part of the financials per se. What we have is a one-line pickup of the profit after tax which comes as associate income. So, the overall revenues do not include revenue from the JV, in case that was the confusion.

Moderator: We move on to the next participant. Next question is from the line of Yasser Lakdawala from M3. Please go ahead.

Yasser Lakdawala: My first question is could you possibly outline a debt reduction road map for the next, say, three to five years? We have obviously post the rights issue, we have done we have reduced the leverage. What would be our sort of long-term road map regarding debt reduction?

Vivek Valsaraj: So, from where we stand today, as a first step, our aim will be to bring the debt down to less than three, and as we keep growing EBITDA further, we will use the incremental cash flows to keep paring down debt. So, one step at a time, the first step is we are currently higher than three, and our aim will be to try and bring it down to less than three, and then start looking at incremental cash flows to pare down debt thereafter.

Yasser Lakdawala: And regarding the cash flows, I think we generated almost, like, I think 500 crores of operating cash flows this first half. What would be the quantum of CAPEX we see ourselves sort of undertaking over the next two to three years based on the order inflows you are getting from some innovative customers our CAPEX requirements in the complex injectables? How do you

see sort of our cash flow being deployed there versus we get a better understanding of what can be used for debt reduction etc., right? So, if you could help us there?

Vivek Valsaraj: So, Yasir and let me talk about FY '24 to begin with. So, in the first half, we spent about 40 million, and in the second half the CAPEX is likely to be anywhere between 50 to 55 million for this particular financial year. Going forward, we will come back with a more specific guidance maybe towards the end of the fiscal as we take stock of what are the requirements from customers for the next fiscal and come back with something later, but for now this is where we are heading for.

Yasser Lakdawala: That would be fantastic. Just a broad level question. You mentioned the bio pharma buyouts of our emerging biotech customers. So, I wanted to sort of understand how does the pipeline work lower to you? Like, does that transaction, M&A transaction enable you to tap into their other assets as well or can you mind them for other lines of business as well, like, if you could just give us a qualitative insight on the conversations that happen at that level and give us a better understanding of how this plays out?

Peter DeYoung: It's a great question. I would say the first thing that typically would happen when one of these transactions were to occur is that the acquiring company would look to understand the supply chain that they acquired through the transaction and if they aren't already one of our customers or if they are a customer but not for that type of offering, it's a great opportunity to introduce them to what we have to offer. And so there maybe not be an immediate benefit from, let's say, cross selling opportunities, but in almost all instances it provides a window to introduce another side of ourselves, and we have seen that to be beneficial in most cases where we can either introduce or reintroduce ourselves to a much larger customer. So, we generally view these events as positive events for us.

Yasser Lakdawala: Relating to the peptide side sort of CAPEX that we have done at our Hemmo facility this entire space is sort of seeing a lot of interest, especially when it comes to GLP-1s, GIPs, where are we in sort of on our journey of supporting potential innovative sort of molecules there? Are we seeing any traction on that side? Are we providing any sort of base level sort of support? If you could give us some qualitative understanding there as well? Because from our understanding of space, I think GLPs have like 20 druggable targets in the human body and it becomes a very exciting area for incremental sort of research dollars. So, if you could help us understand that that would be great.

Peter DeYoung: But say from our background this capability we currently have at that location is really the peptides and not on the nucleotides. That being said, within the peptide area, when we acquired, it was predominantly a generic play. We have invested significantly in the people, the processes and the facility to allow us to be more suited towards what we would call the services segment, which would be the on-patent area, and we have seen some very recent favorable traction with customers as we look to add that additional offering along with our new capabilities.

And so, we would be seeing the mix from the on-patent and the services area in the area of peptides become an increasing contributor and more important to that location as we go ahead. So, we find this to be a more rapid grower, higher margin and a higher ROCE addition to our portfolio, and as the services mix increases, we think that could only become better.

Yasser Lakdawala: One final question on the India Consumer business. How is our sort of profitability trending in that business? And if you could just sort of highlight like our medium outlook on getting that towards company level margins maybe in the next, say, three to five years?

Nandini Piramal: So, I think as we reach our kind of thousand crore target, we expect to see steadily improving profitability year-on-year. So, right now, we would be in single digit, but you would kind of it's not a hockey stick. It would be incrementally growing every year.

Yasser Lakdawala: And really, really glad to see the business turn around and deliver to its potential and congratulations once again.

Moderator: Thank you. Next question is from the line of Sanjaya Satapathy from Ampersand. Please go ahead.

Sanjaya Satapathy: So, my question is that on your deleveraging plan, which you have highlighted, is it going to be predominantly internal accrual or you have some kind of asset monetization possibilities available with you?

Vivek Valsaraj: So, at this stage, it's primarily going to be internal accruals, not really looking for any asset monetization. As you know, our EBITDA takes growth, we will have more free cash flows to look at deleveraging the balance sheet further.

Sanjaya Satapathy: And sir, I understand that while you are facing capacity constraint on certain part of your business, there are other part where the utilization is much lower. Can you just highlight which one are those and how those segments which are lagging behind will also recover going forward?

Vivek Valsaraj: So, if you look at it, and we have explained this broadly to say that we have more capacity in our formulations facilities versus our API facilities, and we have done capacity investments in those API facilities where we have had those challenges and where we thought we had the highest potential for growth and where there was a market demand. So, that's where we have done our investments.

In formulations, we will see some steady increase in the capacity utilization as the years go by, but predominantly, I think our investments have been put in the direction of APIs where the demand has been higher and where there was a need for putting in investments.

Moderator: Thank you. Next question is from the line of Harsh Shah from Dimensional Securities. Please go ahead.

Harsh Shah: My question is more on the macro scale. If I do a very back of the envelop calculation between our India business and overseas business, overseas business I would gather is mainly complex generics and the CDMO part of it, so our asset churn is pretty low on the overseas side, maybe around .5, .6x. So, just wanted to understand, and the ROE is I would guess it would be in the negative territory. So, just wanted to understand what are the levers for us to really wrap up the overseas business? So, if you look at a mid-teen kind of ROE or ROCE for this business, the overseas part, just trying to understand what is the road map and what are the levers that the company has?

Vivek Valsaraj: So, Harsh, if you are looking at the first half, then I think it may not be very representative of the asset turns, because as we mentioned, it's H2 which brings in substantial portion of the revenues for the business, and more specifically for the overseas sites. So, the situation will change as you look at the full-year numbers. That is one.

Secondly, a lot of investments that we made were done recently. For example, the one we did at Riverview or the one which is going on at Grangemouth or the one we did at Canada, so all of them have become part of the denominator where revenues are just starting to come in. And obviously, as the revenues increase, that will also help improve the asset turns.

So, I think, and also if you look at some of the recent acquisitions that we did were also overseas. So, the denominator is higher to that extent more specifically overseas, leading to a slightly lower overturn, and as the revenues improve, this should start showing the difference.

Harsh Shah: Actually, I was referring to FY '23 entire year's number where the asset turnover is .5, .6. So, just wanted to understand what kind of asset sweating or turnover we can expect going ahead? I mean, can we see this move to maybe 1.2, 1.3 kind of number?

Vivek Valsaraj: Yes. So, if you are looking at FY '23, firstly FY '23 may not be a very representative year because we have had an impact on our sales as we have mentioned during the calls in that year. And secondly, yes, we will be looking at asset turns which go anywhere between one-and-a-half, two, and even two-and-a-half in some of the sites. That could be the range depending upon the site that we are talking about.

Moderator: Thank you. Next question is from the line of Alok Dalal from Jefferies India. Please go ahead.

Alok Dalal: So, first question on the sales guidance for the second half. Can you rank in terms of growth which could be the fastest and which could be the slowest in terms of, say, CDMO, complex hospitals, or OTC?

Vivek Valsaraj: So, if you look at it in terms of the sheer absolute value, because CDMO happens to be the largest part, nearly 60% of our revenue comes from CDMO, that's where the largest value driver will be. In terms of the overall percentage, I think more or less all the three businesses would be fairly similar in close range in terms of overall growth.

Alok Dalal: And as far as cost control measures are concerned, I understand at the same time last year, you initiated an exercise to control costs. So, has that already started playing out in margins or should we expect more such cost control measures boosting the overall profitability?

Vivek Valsaraj: So, the initiatives were taken last year as you rightly mention, and yes, they have started showing results, and a lot of it will actually come in H2 as well, because when we sell more, they will start reflecting in the P&L. So, yes, the impact of that you will see going forward as well.

Alok Dalal: And Vivek, one last point on free cash flow generation. So, you mentioned CAPEX, about operating cash flow. Is there room to cut down working capital? Can working capital release give you an extra free cash flow which can be used to pay down debt?

Vivek Valsaraj: So, Alok, that's certainly an area which can. In the current instance one, of course, is given the lumpiness in the sales that we have, we do end up carrying higher inventories higher than normal, and of course, we are also carrying certain strategic inventories to take advantage of the prices. So, if you look at the overall working capital cycle, the current at which we are operating is slightly higher and elevated. So, yes, there will be room for it, and it's an area that we will be looking at.

Moderator: Thank you. Next question is from the line of Tushar Manudhane from Motilal Oswal. Please go ahead.

Tushar Manudhane: So, just on the interest cost now that with the reduction in debt, how much do you consider as the interest?

Vivek Valsaraj: See, there are two parts to it to answer your question. Firstly, the overall interest cost for this particular quarter, if you look at it, we got just one month of benefit of the rights issue because the process closed end of August. So, going forward, we will see some full benefit of reduction to the extent of the debt that we have reduced.

Having said that, the interest rates continue to be high. They are in the range of between 8% to 9%. So, overall, we are seeing anywhere between 11 to 12 million dollars of interest cost in a quarter at this point in time, and of course, we are looking at what we can do to further optimize this. As performance improves, we will be able to probably refinance some of them at lower rates, and those are things we are looking at.

Tushar Manudhane: And just coming back to the asset turn, given the kind of CAPEX which we continue and given the free cash flow maybe post and if I even include the interest cost, will the internal accrual be sufficient to do that kind of CAPEX?

Vivek Valsaraj: So, yes, in terms of meeting the CAPEX requirements, yes. If your question is about debt reduction, it will happen over a period of time. So, it's not going to be a dramatic reduction, but as the cash flows improve, we keep looking at how we can pare down debt.

Tushar Manudhane: And lastly, now that there is a PBT as well, so how much tax rate to be considered?

Vivek Valsaraj: See, we operate in multiple jurisdictions, right. There is India. There is the entire North American part. There is UK. There are several countries in Europe. The highest tax rate is in the range of about 25.17 which is there, and that's what it is. Having said that, the ETR might slightly change because some of the overseas facilities have not yet turned around and are negative. So, ETR might be slightly higher, but on average the tax rate is 25.

Tushar Manudhane: And just one more to squeeze in. As I could see quarter-over-quarter CDMO sales has been better, and I assume that is what is driving the gross margin from 64% to 66%, given that second half will further have higher…

Just on this, as quarter-over-quarter CDMO sales have been higher, I assume that is what is driving the gross margin from 64% to 66% for the quarter. And given that second half will be further higher on the CDMO sales, so how to think about the gross margins?

Vivek Valsaraj: So, as we responded on the first question, this quarter may not be fully representative because we have had higher inventories and inventory overhead credit as far as gross margin is concerned. Just to reiterate, no change from an EBITDA standpoint. Going forward, gross margins in the range of about 64, 65 seems to be reasonable. That's more a normalized gross margin.

Moderator: Thank you. Next question is from the line of Omkar Kamtekar from Bonanza Portfolio. Please go ahead.

Omkar Kamtekar: I just wanted to have, so this is part of the asset turns. Can you give us a blended capacity utilization? Is that possible?

Nandini Piramal: So, a blended capacity utilization is actually quite difficult because we have got 17 sites and different firms. And so it just that number will be meaningless I think.

Omkar Kamtekar: And is it possible for you to give us a broad range of the EBITDA margin segment-wise CDMO, CHS and ICH? Is that possible?

Nandini Piramal: No, we are not doing a segment level EBITDA margin split. Right now, we are looking at overall. We operate in one segment which is pharmaceuticals. We are not getting into vertical level margin split.

Moderator: Thank you. Next question is from the line of Vinod Jain from Wells Fargo Advisors. Please go ahead.

Vinod Jain: I wish to ask on the financial side the question. You have had a situation where H1 and H2 phenomena continues over the years where H1 delivers much lower returns than H2. Now going forward, how do we look at it? Is this going to change, or it will continue because it affects the annual working of the company?

Nandini Piramal: I agree, it does affect the annual working. I think the challenge is, if you think about it, a lot of our customers are pharma companies that actually want to run down inventories by the end of the calendar year and then pick up inventories in the first quarter of the calendar year which ends up being our last quarter. So, I agree this is challenging, but that's kind of how the industry works. And quite often, our factories will be busy actually creating and producing in order to deliver in H1, but that only kind of shows up, I mean, that will show up in the last quarter.

Vinod Jain: So, is there any possibility of further cost reduction in the first half? Because the first half typically shows negative results and that hurts all working out, of course.

Nandini Piramal: Yes, unfortunately, in the CDMO business, I think our costs are relatively fixed. And two is like as you noticed, our inventory is a bit high. That's because we have kind of bought the materials and are producing them in order to deliver in H2 so the kind of a factory is working so to speak in order to deliver.

Moderator: Thank you. Next question is from the line of Bharat Gupta from Fair Value Capital. Please go ahead.

Bharat Gupta: I have just one question, and that pertains to one of the statements which was made by the chairman prior to the demerger. So, in the pharma business, the chairman highlighted that the margins is likely to be on the improving trajectory, and that remains to be near about 25% odd levels over next 4 to 5 years.

So, now with nearly one-and-a-half years passed by, so how do we see, like, are we still on the target to achieve and sustain the margins of about 25% over the next four to five years? And what can be the growth levers likely to be there across the different segments?

Nandini Piramal: So, I think, obviously, last year we had a tough year. So, I would say we are back on the improvement trajectory, and I think you could say mid 20s margin is something that is feasible in the mid-term.

I think the growth levers would be increased revenue from our CAPEX that we have invested. So, as Vivek mentioned, we have actually just opened our Grangemouth CAPEX. We got our first revenue milestone last quarter and would expect to see revenues from that going forward. Similarly, we have made growth investments in Riverview as well as Turbhe and Aurora. So, I think we should see increased revenue coming from that as well as I think we will continue to focus on cost, but we believe that operating leverage will help us.

Bharat Gupta: And particularly with respect to the product mix, currently, if I look at the CDMO space, so innovative category constitutes close to 45% of the overall top line. So, in order to the margins to sustain over 20%-odd, so where do we see the products mix change changing over the next four years?

Nandini Piramal: So, I think as you rightly noted, our innovator product mix is something that has been increasing over the last 3 years. We expect that to continue further. I don't think we have a particular target in mind, but I think that will also help us in creating sustainable operating margins.

Moderator: Thank you. We move on to the next participant. Next question is from the line of Sanjeev from SKD Consulting. Please go ahead.

Sanjeev Kumar Damani: Ma'am, I have two little questions. One is regarding the fact that we have added lot of orders in this quarter. So, what is the visibility of turnover from CDMO in the next quarter? How much we are going to execute out of the total pending order? That is one.

Secondly, now with the right issue 1,000 crore in our kitty, the next six months interest outgo if you can kindly give some ballpark figure?

Vivek Valsaraj: So, firstly, we have given guidance for H2 in terms of a high teens growth and that takes into consideration the kind of order book we have. So, it's already factored in that we have a certain visibility based on which we have given this guidance.

And secondly, in terms of interest cost, while we have used that to pare down debt, our debt volume has come down, but we are mindful of the fact that interest rates continue to remain high and based on what we hear from the macro environment, it might remain at those levels for some time. So, currently, we have said that we have about 11 to 12 million dollars of interest outflow in a quarter, and of course, we are making attempts as whatever we can do to reduce the rates going forward.

Sanjeev Kumar Damani: Sir, can you give some figures of turnover so that we can understand the execution that is possible for the pending orders? Sometime the orders are being given, but the execution doesn't start with the order receipt.

Vivek Valsaraj: Correct. So, if you have looked at our historical performance, H2 has been higher, and that's based on the execution that has been done in H2, right.

Sanjeev Kumar Damani: I understand that you are not able to quantify. I mean, if you cannot quantify, then please say no about it. I meant figures to be given to me about CDMO turnover. That's all.

Vivek Valsaraj: So, as we mentioned, we are giving a broad guidance. We are not quantifying a number.

Sanjeev Kumar Damani: No problem. There is no objection. So, one more, sir. We have 17-18 sites all over the world. So, is there any way we can consolidate and reduce our cost of operations? Is it likely in the near future?

Nandini Piramal: One of the benefits of our 17 sites is that they actually almost serve different customers and have different specialties to some extent. And customers quite often will say, look, I want it in, for example, I want something made in North America or they say, I want something made in India. So, geographically, they may have a preference, and they also might have a preference for the kind of team and the kind of dosage form etc.

So, what we see that going forward is that as revenues increase, you will get benefit of operating leverage once the sites reach a certain scale. So, what you will see going forward is that the cost will form a smaller part of the overall.

Sanjeev Kumar Damani: And last question. Generic business, sorry, innovation and patent, are we also looking to register our own patent either process patent or any such thing? Are we already registered and have got some patent or are we looking for that kind of growth also in future?

Nandini Piramal: No, I think at this point, we have no plans to do our own products in the new chemical entity domain.

Moderator: Thank you. Next question is from the line of Namit Arora from Indgrowth Capital. Please go ahead.

Namit Arora: My question was slightly medium-term over the next three to five years. So, you have three very interesting businesses, and all the engines foundation is in place for CDMO, CHG, and ICH. I just wanted your thoughts on in terms of capital allocation as well as management bandwidth. How do you think about these three businesses over the medium term given that all of them are extremely promising and all of them have a very solid foundation?

Vivek Valsaraj: So, Namit, I think we have kind of been speaking about it. Firstly, in terms of our consumer products business, as we said, is self-funding. So, whatever the EBITDA it has generated, we have used large part of that for our promotional investments and media investments that we have done as far as this business is concerned.

Between Complex Hospital Generics and CDMO, CDMO being the larger part, and the nature of the business is such that it is capital intensive will have a higher allocation of the overall capital outlay as it has been in the past and will continue in the future as well.

Namit Arora: And in terms of the internal organization in order to make sure that these three businesses all realize their full potential, if you could just give us a flavor of how you organize internally in terms of Senior Management to ensure that these two businesses realize their full potential?

Nandini Piramal: So, we have Peter DeYoung who is CEO of the global pharma business. Under him, he has the Chief Operating Officer, Herve Berdou who is based in the U.S., as well as the Chief Commercial Officer Stuart Needleman who is also based in the U.S., as well as a CFO.

Similarly, in the Complex Hospital GENERICS, you have a President and I think CEO who is Jeff Hampton. I think we just recruited him. We just announced his recruitment in June. So, he would be also based in the U.S., and you have a CFO, separate CFO as well.

Similarly, in the OTC business, India Consumer Healthcare, you have a CEO and a separate CFO and sales head etc. So, I think they are all, each of the business does have separate management, but yes, so we are involved quite closely also.

Namit Arora: My final quick question. Historically, the group has had a phenomenal track record in terms of acquisitions and building businesses inorganically as well over the last several decades. But I am just keen on your thoughts given that organically also things are going well, so are you going to keep an eye out for some interesting opportunities in any of these three businesses or is the focus right now more internal driven and organic?

Nandini Piramal: I think it's absolutely we always continue to look at acquisitions, but I think acquisitions have to earn the right to kind of be invested in almost. And so, it will depend on what the returns are. I think I would say that the first priority is for them until the end of the financial year, as Vivek said, we want to reduce our debt to EBITDA to below three. So, that's the first and current plan. And then we will also continue to look at acquisitions.

Moderator: Thank you. Next question is from the line of Amit Kadam from Canara Robeco Mutual Fund. Please go ahead.

Amit Kadam: So, my first question is that as the business recovers and it's clearly showing in the numbers, what is still a weakling in that overall business which warrants management attention? And that's point number one. It may be also like some kind of industry some breathing headwinds. Something on that also will be very helpful.

The second question is that employee cost is a significant part of our business. It still like sequentially went up. Any ballpark maybe number in terms of like how do we build it in terms of going forward? And what should be the correct base? So, that's another point.

Nandini Piramal: See, I think, overall, as you rightly noted that the macro trend in terms of biotech funding is recovering but still not back into the boom years. So, obviously, that is an overall headwind for the entire business. While we have rebalanced our business a little bit between biotech and big pharma the biotech are still a rather important component of this business because that is where innovation has been happening over the last few years. So, I think that's something that is to be a continued watch out.

Peter DeYoung: I was going to say from my overall priorities' perspective, we would say that securing the appropriate level of forward sales commitments from our customers is obviously a critical part for the CDMO and getting a lot of management attention. We have obviously seen some positive results from that, but it's an evergreen activity that needs to be accomplished.

I would say the second thing is that we do have a small number of sites that we are focused on improving our operations in terms of OTF and right first time, and those are getting our attention. And I would say the third component for the CDMO would be on our cost program while for the convention we have seen some good results from that. Cost is another area that always does need attention and focus, and it's going to get our continued attention.

If you look at the CHG business, we did have a period where we had demand in excess of our ability to supply, particularly with our internally produced products since we have an important operations and CAPEX plan underway that should allow us to get more control over those critical products. Then obviously, there is commercial execution once that supply becomes more available.

And then the third bit would be on our pipeline. Obviously, growth will require some amount of execution on our pipeline products, and we want to do what we can to secure that, the prosecution of that, and the eventual commercialization. And obviously, cost remains common across those. I don't know if you want to mention anything on the…

Nandini Piramal: Employee cost.

Vivek Valsaraj: Employee cost, some bit of increase or variation over the quarters you will see. It's kind of stabilized now if you look at it and compare over the last couple of quarters, but across quarter, sequentially, you may see some movements, but they are not very material, and it depends upon the kind of recruitment to kind of ramp up production at a particular site and a little bit of variation you will see across sites.

Amit Kadam: But still like can you be clearer like on this part and how do we see this thing? Because here I see that we had a like the number what we are in terms of 27% of our top line are now employee cost. We used to operate at much lower. Maybe operating leverage is something which is still yet to be played out, but that's what I wanted to see.

Because from where I am trying to come is that maybe few years back, because our resources are also internationally based, 2%, 3% kind of inflation based maybe hikes would have been a case and ballpark we could have built 5%, 6% as an incremental maybe cost going in this particular, but as the overall interest rate itself globally has moved up, the expectation for salary hikes are also up.

So, just wanted to know should we consider at like 8%, 9% as an annual increase on a base what maybe on whatever we form in FY '24? Is that a way of building a few things or how the management is looking forward? Because it's a significant number to our overall things, scheme of things in bring maybe operating leveraged things to kick in.

Vivek Valsaraj: So, Amit, couple of points. If you look at the blended rate of normal inflation-linked increase between India and overseas, it will come to about 6%, 6.5%. That's what the rate normally is. Also, if you are trying to look at employee cost as a percentage of revenues for our kind of business where there is so much of lumpiness, obviously, it throws very erratic numbers across quarters, and if you are going to base this on FY '23, that may also not be representative because of the kind of impact that we took on the business. So, overall, I think you need to look at full year number this year to be able to get some idea of what employee cost as a percentage of revenue looks like, but the increase will be more or less on an inflation-linked increase, it will be more or less linked to the 6%, 6.5%, and then if we add people, that will be on top of on currency.

Nandini Piramal: If you think about it, to open our Grangemouth expansion, we actually had to do significant recruitment in Quarter 1 and Quarter 2 in order to actually open it. So, that is part of the increase in people that you would see.

Vivek Valsaraj: Also, Amit, you may want to pay attention to the FOREX part of it. So, there is about 3.5% impact that just comes in because we translate overseas in INR, and there is FOREX impact coming in as well.

Moderator: Thank you. Next question is from the line of Chintan Shah from JM Financial. Please go ahead.

Chintan Shah: The first question is, why we understand that we need overseas manufacturing presence for CDMO segment as we intend to be closer to the partners, but for Complex Hospital Generics segment, which is more of a distribution like business, do we really need to have overseas manufacturing facilities? If can you please help me understand?

Peter DeYoung: So, I would say that the capability was actually acquired which is how it's placed where it's at, and it has been grown organically through additional incremental CAPEX in that location, and so that has given where the asset was when it was acquired and the capability at that asset that was there. And that is going to continue for the benefits of essentially what we call largely sunk investment, and we have had very good returns from that business and very good financial profiles. And so if you were to look at that business's financial performance, it would meet most of your target metrics.

If you listened to the earlier bit of the comments, we did describe that we are making incremental CAPEX investments at the moment in both our Digwal and our Dahej facilities to support that business, and that's where a significant amount of the incremental capital is going for capacities and capabilities for complex hospital generics going forward.

Chintan Shah: And secondly, not from a near-term perspective, but from medium to long-term, which is, once things normalize, what sort of steady-state potential in terms of ROCE does the business have, if you can just maybe give a range or number etc.?

Vivek Valsaraj: Sorry, was your question as a guidance on the ROCE?

Chintan Shah: So, more so in terms of the potential that the business has to deliver, not necessarily specific guidance that we would like to achieve. If you can just help me understand?

Vivek Valsaraj: So, this is ROCE for the entire business or ROCE only for the Complex Hospital Generics?

Chintan Shah: No, for the entire business?

Vivek Valsaraj: Overall, as our margins improve, first of all, ROCE is obviously a factor of improving the profitability. So, as margins improve and move towards the range of 24%, 25%, we will see ROCE in the high teens for the overall company.

Chintan Shah: And last question is on the CDMO side. So, do we have a target for the innovative share over the next three to five years that we are going to reach? And supplemented to that, would that means that innovative business will be growing faster or would be growing a bit slow on the generics side?

Peter DeYoung: So, we as mentioned earlier, we haven't given a specific quantified target for the innovative share, but we do expect both innovator and generic to grow. But as demonstrated in the past and based on where we are seeing the customer demand, we would expect the innovative business to grow at a faster rate than the generics business.

Moderator: Thank you. Ladies and gentlemen, we will take that as the last question, and I will hand the conference over to Mr. Gagan sir for closing comments.

Gagan Borana: Thank you very much. Hope we have answered all your questions. In case you have any follow-up questions or any clarification, please feel free to reach out to me, and I will be happy to respond. Thank you and have a good day.

Moderator: Thank you very much. On behalf of Piramal Pharma Limited, that concludes this conference. Thank you for joining us. You may now disconnect your lines. Thank you.