“Laurus Labs Limited Q2 FY2019 Earnings Conference Call”
November 02, 2018

Moderator: Ladies and gentlemen, good day and welcome to the Laurus Labs Ltd's Q2 FY2019 Earnings Conference Call hosted by Kotak Securities Limited. As a reminder, all participant lines will be in the listen-only mode, there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. I now hand the conference over to Mr. Chirag Talati from Kotak Securities. Thank you and over to you Sir!

Chirag Talati: Good afternoon everyone. On behalf of Kotak Securities, I thank the Laurus Management team for giving us the opportunity to host this call. From Laurus we have with us today Dr. Satyanarayana Chava, CEO, Ravi Kumar, CFO and Monish Shah from the Investor Relations Team. I hand over the call to the management for their opening remarks. Over to you Sir!

Dr. Satyanarayana Chava: Thank you Chirag. Thank you everyone for taking time joining us on our results conference call. I would like to wish you very Happy Diwali in advance.

Moving on to the business highlights for Q2 and H1 FY2019. Our net revenues is at INR 588 Crores for the quarter and INR 1,127 Crores for H1 showing a growth of 9% and 11% year-on-year basis respectively and our major business segments have reported healthy revenue growth during the quarter.

I would like to spend some time on giving more updates on our formulation business where we are spending a lot of resources both people and money. I would like to share that we have transferred our US ANDA of Tenofovir to CASI Pharma for a consideration of ~$3 million of which we received 0.7 million and we will receive rest of the money based on the milestones and most of it will be in FY2019. Both parties are also in discussion to allow Laurus to continue to manufacture and market Tenofovir in the US market.

Potentially we also supply API for China market where Tenofovir is the most preferred drug for HEP-B. However we will continue to sell Tenofovir formulations in various countries other than US. So this deal is predominantly allowing CASI Pharma to capture opportunities in China for opportunity in HEP-B.

We have filed 16 ANDAs in the year so far, 5 dossiers in Europe, 2 in Canada, 5 with WHO, 2 dossiers in South Africa and also we filed 2 dossiers with DCGI in India for approvals. Apart from this we filed close to 60 dossiers in several African countries and also Asia, so that means our formulation business we are taking globally we are not taking only market specific approach. Of the 16 ANDA filed in US with this we have 2 Para IV opportunities and also potential 7 first to file opportunities. All these put together we have in excess of $10 billion addressable market size right now. We target to file 10 ANDAs every year and file these products globally wherever there is opportunity.

During the quarter in discussion we also renegotiated our partnership with DRL and Rising by reducing products under partnership from 18 to 7, which has resulted in higher cost related to development activities and development fees paid back to the partner. This resulted in higher other expense compared to the sequential quarters. During the quarter we filed 4 ANDAs with FDA that also increase our R&D expenditure significantly. We are also happy to share that the engaged in contract manufacturing of a formulation for US market based on our in-house API and we began commercial manufacturing last month.

As you are aware we have received approval from global fund for Dolutegravir base fixed dose combinations and it enables us to participate in various In Country tenders. We also filed this product with various other countries. Very soon we will be filing another important product in ARV, the Tenofovir, Lamivudine, and Emtricitabine combination that will allow us to capture and participate significant combination business in antiretroviral therapy.

Development of other key products in the first year in second line is going on as per our strategy and we expect to complete all the development by December 2019. We also successfully completed several regulatory inspections including US FDA, European and other African regulatory authorities for our finished dosage forms unit. If you see these activities we are taking a product specific global approach rather than a market specific.

Any revenue in formulations for us is EBITDA accretive and I am happy to share in the H1 of current financial year we generated close to a million dollar revenue in formulations. When comes to the segment growth, our ARV business grew 17% when compared to H1 year-on-year on the back of increased volumes for the existing products. We continue to see volume growth for our key products.

We are also happy to share we have completed backward integration of our key ARV products Emtricitabine and Lamivudine and we see the benefit will come from Q3 onwards. We are also in talk with our customers for price increase wherever there is a possibility. Lamivudine production capacity is operational and we expect commercial supplies during Q4 based on regulatory approvals expected.

We are also working on a several second line ARV APIs and with this we will complete key market of ARV offering both first line and second line and this will be ready by first quarter next financial year. I am very optimistic about the future of ARV business on the back of all these initiatives and confidence from various customers.

When it comes to Hepatitis C during the quarter we saw the Hepatitis C business stabilized and quarter-on-quarter it grew very well. I am also expecting our partner to get approvals in some markets, which will aid any stress in the domestic market. Hepatitis C will maintain current level of revenues in the near future, but it is a good sign we do not expect any drop in this business further.

Onco APIs growth is as expected we grew 22% on year-on-year quarter, 11% for the first half of financial year. We are also looking to introduce few new products into the segment and we expect to complete validation of two new products in FY2019 and we also completed expansion and commercialized a few products from the newly expanded onco facility.

In the other API segment, we saw significant growth because of commencement of supplies of contract manufacturing to our key European partner. We are also happy to share that we started commercial sales of Metformin.

In Synthesis business this is the robust growth we saw almost 60% year-on-year growth when compared to the H1 versus FY2019 versus FY2018. Unit V supplies were on schedule and we continue to see good traction in CMO business based on various customer commitments and RHPs we received. We are very optimistic on the growth of Synthesis business from Aspen and various other customers. In ingredient business also, we grew 28% on quarter-on-quarter and 8% year-on-year, but our approach to this business is to replicate generic API model focused on developing new technology where we make natural identical ingredients for both cosmetic and nutraceutical industries.

We also started supplies of Digoxin to our CMO partner C2 Pharma. We are currently developing few natural extraction based APIs to leverage our infrastructure in unit IV. Unit IV is also adding capacities to do more API validations and we completed two validations from that unit. With that I will hand over to Ravi to share some financial highlights.

V.V. Ravi Kumar: Thank you Dr. Satya. Very warm welcome to everyone and wishing you all a very happy Diwali in advance. Total income from operations for the quarter stood at INR 588 Crores as against INR 539 Crores corresponding quarter last year and the H1 grew by 11%. We are happy to see that all the major businesses have shown a revenue growth, but the gross margin have also show growth sequentially. However, EBITDA margins have not improved because of three major reasons, the first reason is the forex losses – as you all aware that the rupee Depreciated close to ~6% in the quarter itself and the impact was close to INR 17 Crores and out of this INR 17 Crores, INR 15.5 Crores belongs to the unrealized forex loss. What does this mean is that the unrealized forex loss is basically on the long-term loans all these long-term loans are payable over a period of six years time. And on mark-to-market basis we have restated these financials based on the latest exchange rate as on September 30, 2018.

And the second point is as Dr. Satya said we have renegotiated the FDF contract with Rising Pharma and Dr. Reddy for about five products whatever we have filed before now those five products were taken back and then the money paid by them. So we have returned them those expenses and that is the one additional cost we incurred that is the one off expense and if you look at the formulation slide in the investor presentation we have filed about 4 ANDAs in the second quarter in US, 5 ANDAs in Europe, about 9 ANDAs we filed and each ANDA is costing around $180000 which put together is close to ~INR10 Crores which was expensed in the quarter. I can say it is majority of the INR 10 Crores is one off because we are not envisaging this kind of a run rate for every quarter.

Third of course the raw material prices from China, the prices have been at the same level or similar level at Q1, so we have gone for a backward integration. Those backward integration benefits will come good from third quarter onwards. And from November onwards we are expecting to get benefits out of the backward integration projects. So these are the three reasons for the EBITDA and then PAT reduction. Our diluted EPS for the quarter stood at Rs.1.5 and INR 3.1 for H1 FY19. On the capex front we expect to be spend around INR 250 to 300 Crores, again we have taken a conscious call, we have more than INR 800 Crores of assets which are not generating or generating very meager revenue as of today. We are not initiating any new capacity initiatives, the two capacity initiatives, which are going today is one is for the PMPA production block, another for the contract manufacturing, other than these two we are not initiating any major capex in the coming period until we utilize the existing unutilized capacity. With this I request the moderator to open lines for the Q&A.

Moderator: Thank you. We will now begin the question and answer session. The first question is from the line of Vijay Sarabhi from Nine Rivers Capital. Please go ahead.

Vijay Sarabhi: I have basically two questions. The first is on the royalty payment of $2 million that you said you will receive before end of the financial year. The question is whether how is it treated, is it an advance payment or is it like you directly added to your income statement?

Dr. Satyanarayana Chava: It is an income it is not an advance payment.

Vijay Sarabhi: So it is completely entire $2 million would expect it to be added to your bottomline going forward?

V.V. Ravi Kumar: Yes this will be done in the third and fourth quarter.

Vijay Sarabhi: But out of which you have already received 0.7 million right?

V.V. Ravi Kumar: Yes, this will be reflected in Q3 FY19.

Vijay Sarabhi: In the presentation you have mentioned that you will be applying next month for approvals tentatively can you provide us when do you expect approvals and any sort of timelines for launching the product?

Dr. Satyanarayana Chava: We are filing dossier for Tenofovir based fixed dose combinations and we expect one tentative approval this month in November and another product approval we expect in January so approvals are on track.

Vijay Sarabhi: So TLE have you I thought you are going to file for TLE right it is not get applied?

Dr. Satyanarayana Chava: Not yet filed only we have filed Dolutegravir based fixed dose combinations DLT. The TLE we are filing probably in two weeks time.

Vijay Sarabhi: So any timelines that you could provide you could throw some light on TLE?

Dr. Satyanarayana Chava: It is difficult to predict right now, but nine months is a good estimate right now.

V.V. Ravi Kumar: Actually here we need to keep in mind all three APIs already been reviewed, so it is only a dossier review which is pending which may take nine month time for approval.

Vijay Sarabhi: So you would have to submit something like basically by discussing with other companies you would have to get data of three months data, six months data or what is the plan for TLE?

Dr. Satyanarayana Chava: We concluded six months stability data, and the data is under compilation right now.

Vijay Sarabhi: Data is under compilation, so you would probably provide six months data?

Dr. Satyanarayana Chava: Yes.

Vijay Sarabhi: Thank you. That is all.

Moderator: Thank you. The next question is from the line of Ananda Padmanand from Renaissance. Please go ahead.

Ananda Padmanand: Sir could you throw some light or could you give some colour on how the gross margins on your ARV business would have moved in the last couple of quarters and to what extent we would be able to recoup those margins based on your backward integration and based on combination of newer products in the ARV business?

Dr. Satyanarayana Chava: We expect gross margins to improve by ~2% points because of backward integration.

Ananda Padmanand: And to what extent they would have eroded in the last one or two from Q4 to Q1 or Q3 FY2018 to Q1 FY2019 what extent they have eroded?

Dr. Satyanarayana Chava: I would say maybe 3% I am talking about overall ARV as a basket.

Ananda Padmanand: ARV as a basket?

Dr. Satyanarayana Chava: ~3%.

Ananda Padmanand: So of that you will be able to recoup 200 basis points after you do backward integration and after you launch newer combinations in the ARV basket?

Dr. Satyanarayana Chava: Yes, As per backward integration.

Ananda Padmanand: And would it further improve and you launch the Dolutegravir combination drugs and your TLE combination drugs would it further improve?

Dr. Satyanarayana Chava: That is for the formulations I am talking about the API, so in two quarters we will recoup whatever gross margin lost because of the higher RM prices from China we will recoup that in two quarters.

Ananda Padmanand: And your Hep-C what would be the gross margins now after the price erosion?

Dr. Satyanarayana Chava: We are not giving the segment wise gross margins, but the quantum of the business improved from Q1 to Q2 and we expect it remain at these levels which is a good sign for us.

Ananda Padmanand: But would the gross margins have also got significantly eroded in Hep-C also in the last one or two quarters?

Dr. Satyanarayana Chava: No, it is stable.

Ananda Padmanand: Thank you. That is all from my side.

Moderator: Thank you. We have the next question from the line of C Srihari from PCS Securities. Please go ahead.

T Srihari: Sir on the API front I had a couple of questions, firstly we see that on the ARV side the gravitation is happening more towards TAF so what is the strategy approach for that and you had earlier guided for an 8% kind of a growth for the ARV portfolio do we still stick with that and I notice that the other APIs has shown very good traction so what is the kind of growth we expect for that segment. On the formulation side we have three antidiabetic filings, so is it predominantly Metformin and if you can please give some kind of a topline guidance for the formulations segment that will be helpful? Thank you.

Dr. Satyanarayana Chava: I will try to answer in the same sequence. We do not expect any business for TAF in the next three years even the funding agency and regulators are not putting any TAF based regimens into the treatment even by WHO or global fund so we do not expect TAF will take any share of the ARV market right now. And on ARV growth, we expect to grow single digit fortunately in the first half we grew more than that and we expect to grow a single digit based on our foray into second line ARV APIs. We are still hopeful of achieving single digit growth in ARV next year as well and when comes to other products our contract manufacturing of APIs for other generic customers is going very well and that business will be substantial in the H2 it will continue to grow in the next financial year as well. When it comes to FDF we have some committed orders for next financial year so we will continue to ramp up our ARV API sales for emerging markets and also our ARV Finished dosage form for emerging market, so that is a tender business, so we do not know how much we are going to win right, but otherwise from the European customer we have committed orders for next financial year.

T Srihari: So what would that be at least in volume terms of your let us say optimum for that business?

Dr. Satyanarayana Chava: Right now we have commitments from partner 0.5 billion tablets per year and we are also talking with them for another 0.5 billion and that will take about 20% of our capacity for the next financial year. Out of 5 billion capacity we have already 10% committed by customer and another 10% we have negotiated.

T Srihari: This excludes emerging market opportunity?

Dr. Satyanarayana Chava: That excludes yes, that is only for one customer for two products.

T Srihari: So overall what would be the fill out like?

Dr. Satyanarayana Chava: We do not want to give how much revenue we generate out of that, but one important thing you have to note APIs for these formulations are manufactured in-house, so this is a forward integration project from API to formulations.

T Srihari: So what is the kind of asset turnover generally what is the estimate?

V.V. Ravi Kumar: On a normalized basis 1.5x to 2x.

T Srihari: Depending on the pricing scenario?

V.V. Ravi Kumar: Yes depending on the pricing scenario and the product mix.

T Srihari: Fine. Thank you.

Moderator: Thank you. The next question is from the line of Charulata Gaidhani from Dalal & Broacha. Please go ahead.

Charulata Gaidhani: You just mentioned that there is a commitment for 0.5 billion from one customer your capacity is currently 5 billion if I am not mistaken and how much time will this take to reflect in the revenues?

Dr. Satyanarayana Chava: We already started commercialization of the product in October so our first commercial shipment will start in November and we have orders from November onwards till end of December 2019, so this is the regular product to our partner and we expect to do about 40 million tablets per month that is the current order position we have.

Charulata Gaidhani: Then during the quarter why was the ingredients business down?

Dr. Satyanarayana Chava: That is based on the delivery schedule which is year wise and we will continue to grow in ingredients business, what we have produced is purely based on delivery commitments from the customers.

Charulata Gaidhani: So that should come in the next quarter?

Dr. Satyanarayana Chava: I think second half of the financial year.

Moderator: Thank you. The next question is from the line of Ranveer Singh from Systematix Shares. Please go ahead.

Ranveer Singh: My question relates to that formulation part can you give some indication whether formulation business as a whole is profitable now, so in terms of total R&D spent and then the revenue currently we are getting?

Dr. Satyanarayana Chava: Our formulation, R&D, opex, interest, depreciation, everything is close to INR 150 Crores per year right now.

Ranveer Singh: Sorry how much?

Dr. Satyanarayana Chava: INR 150 Crores. So we expect the next year not only we generate INR 150 Crores worth of gross margin maybe beyond that, but right now this year we do not expect to recoup all that expenditure we have done in the formulations.

Ranveer Singh: So in FY2019 that would be breaking even and in FY2020 we will have some profits that is what you are saying?

Dr. Satyanarayana Chava: Yes absolutely.

Ranveer Singh: And can you give some timeline for that combination drug would be coming in Q3 or Q4?

Dr. Satyanarayana Chava: See Q3 we will have revenues coming, already we are going to shift commercial products, and we expect to have even some emerging market ARV business in Q4, so our investments, and our commitment towards business has started showing results.

Ranveer Singh: And how many ANDA launches we have in mind for FY2019 and 2020 also if you could give some guidance?

Dr. Satyanarayana Chava: Although we got Metformin approval, we will be negotiating contracts and we will probably ship during this quarter and we expect to launch two products during Q4, so this year we will eventually launch three products.

Ranveer Singh: And for 2020 also we have got some timeline some indication for our ANDA pipeline?

Dr. Satyanarayana Chava: We expect to file close to 10 products per year.

Ranveer Singh: Sorry I joined late actually have you given any guidance after now half year result is in hand so for the full year guidance have you given something?

Dr. Satyanarayana Chava: No. We have not given any guidance.

Ranveer Singh: But H2 definitely be better than H1 that I understand, but thing is what integration we are talking about would be a gradual or that we will see Q3 recouping suddenly to our historical level how the thing should unfold?

Dr. Satyanarayana Chava: The backward integration is not yet implemented so there was nothing we have to say based on R&D so everything went commercial last month.

Ranveer Singh: And R&D also this quarter has been a little higher so this has been bunched up something front loading so that level will sustain or we see some this expenditure residing in subsequent quarters?

Dr. Satyanarayana Chava: The majority of R&D expenditure increase was due to we filed 4 ANDAs in Q2, so we do not expect to file 4 ANDAs in Q3 and another 4 ANDAs in Q4 we expect some softening of R&D expenditure in H2.

Ranveer Singh: And what will be the capitalized portion of R&D currently?

Dr. Satyanarayana Chava: Zero.

Ranveer Singh: So everything is expensed out?

Dr. Satyanarayana Chava: Yes everything is expensed.

Ranveer Singh: Thanks a lot Sir! I will have some question will be in queue.

Moderator: Thank you. The next question is from the line of Damayanti Kerai from HSBC. Please go ahead.

Damayanti Kerai: My question is regarding your contract manufacturing business, so can you elaborate how the demand scenario is looking right now for that segment and which are the key markets where you are seeing higher demands and second part of my question would be are you seeing more opportunities emerging to two supply issues in China for your contract manufacturing segment? Thank you.

Dr. Satyanarayana Chava: We do Contract manufacturing in two divisions one is contract manufacturing for APIs for generic customers where there was cost increase because of some challenges of sourcing from China where we seeing a huge growth. And we also do contract manufacturing for Big Pharma for their clinical programs both divisions are going very well. The biggest growth what we saw was in our contract manufacturing of clinical based molecules to Big Pharma.

Damayanti Kerai: In the generic part do you think China opportunities are transit in nature or are you seeing some opportunities to come permanently to us?

Dr. Satyanarayana Chava: Permanent to us. The customers are transferring their drug master files to us, so those are permanent. I do not think it is a temporary phenomena.

Damayanti Kerai: Thank you.

Moderator: Thank you. The next question is a followup question from Charulata Gaidhani from Dalal & Broacha. Please go ahead.

Charulata Gaidhani: Sir my question pertains to Metformin what is the size of the opportunity that you see?

Dr. Satyanarayana Chava: We are negotiating contracts so I do not want to say how big those will be right now, it is too early to predict.

Charulata Gaidhani: But since it is quite generic molecule what type of, how much business would you anticipate?

Dr. Satyanarayana Chava: We need to wait three, four quarters to demonstrate how much market share we are able to garner in US and Europe. Right now it is too early to say what percentage we will capture.

Charulata Gaidhani: Have we got approval?

Dr. Satyanarayana Chava: Yes, and in Europe the file is on review, in US we got approval for our ANDA and right now we are just scaling up to the bigger batches.

Moderator: Thank you. The next question is from the line of Apurva Mehta from AM Investments. Please go ahead.

Apurva Mehta: Sir I just wanted to ask Q3 will be back out with our original EBITDA margins of 22%, 23%?

Dr. Satyanarayana Chava: It will be close to 20% that is what we can tell you.

Apurva Mehta: And on the formulation side when can we expect some big revenues coming in from Q4 or maybe from next year?

Dr. Satyanarayana Chava: We have done in ~1 million in H1 FY19 and if you do $2 million it is significant? If you do $4 million it is very significant? The quantum jump will come in next financial year, but you will see some revenue increase in Q3 and more revenue increase in Q4, but quantum jump will come in FY2020.

Apurva Mehta: Sir what type of revenue growth in FY2020 when lot of our asset will start sweating what type of growth we can expect and what type of EBITDA margins when we can just ballpark it?

Dr. Satyanarayana Chava: We are not giving any guidance.

Apurva Mehta: Roughly because lot of assets because INR 800 Crores of asset is just lying idle, so from that if you put into some perspective that this many asset will start sweating in, so we can get some figures from that, that we will get some type of a decent growth and decent EBITDA margins?

Dr. Satyanarayana Chava: Before venturing into finished dosage forms if you are able to recollect our EBITDA percentages were at 22%, 23% as a pure API company. So right now with that money what we are having APIs we are putting into infrastructure, putting into finished dosage forms once the

finished dosage forms starting giving positive gross margin then you can imagine we should do more than 23% EBITDA that is very logical. So probably you can expect 23%+ once you get our formulations becoming cash positive.

V.V. Ravi Kumar: Dr. Satya is saying by fully optimizing the formulation facility there is a possibility, we can achieve those numbers.

Apurva Mehta: Sir you had guided for a single digit growth in ARV, but in first half you have done close to 17% so that means on the second half we are not expecting any growth or maybe very low growth?

Dr. Satyanarayana Chava: No, we expect growth.

Apurva Mehta: Yes because you have stated that we will be in a single digit growth so if we subtract from that whatever it is there then we would be close to a very low growth type of thing.

Dr. Satyanarayana Chava: Based on the current indications we expect to grow H2 of last year to H2 of this year we expect to grow.

Apurva Mehta: Thank you and wish you all the best.

Moderator: Thank you. The next question is from the line of Dheeresh Pathak from Goldman Sachs Asset Management. Please go ahead.

Dheeresh Pathak: The contract manufacturing of API for generic companies and you said also contract manufacturing for clinical programs so both are clubbed together and shown as synthesis or they are shown separately can you just explain the way?

Dr. Satyanarayana Chava: Those are shown separately. Generic API contract manufacturing is coming in other APIs, whereas the contract manufacturing clinical based programs coming in Synthesis.

Dheeresh Pathak: The synthesis is only clinical right now or something has gone commercial as well?

Dr. Satyanarayana Chava: We went commercial for three products right now.

Dheeresh Pathak: Can you give a split of the INR 50 Crores of quarterly revenue how much is commercial and how much is clinical?

Dr. Satyanarayana Chava: 10% is commercial for sure. I do not have exact number to give you at least 10% is commercial.

Dheeresh Pathak: The other API is down on 1H basis it is down like some 10% or so, which is basically you are saying is contract manufacturing of API for other generic companies so why is that so?

Dr. Satyanarayana Chava: When you compare Q1 to Q2 there is a significant growth and whereas H1 last year to this one is less because we did not deliver anything in Q1, but going forward for Q3, Q4 we already have significant order book.

Dheeresh Pathak: So why are you doing contract manufacturing why are you not selling spot?

Dr. Satyanarayana Chava: See those product DMFs are owned by our partner they are only transferring the technology to us as the additional manufacturing side, so actually in one way that is good what is the raw material cost, what is the gross margin we can add, what are the tonnage, so that business is more predictable and highly profitable.

V.V. Ravi Kumar: It will be very easy for the customer to transfer also.

Dheeresh Pathak: Yes but do they leave enough return like you just spending on the reactor capacity infrastructure does it leave enough return?

Dr. Satyanarayana Chava: Yes.

Dheeresh Pathak: Second question you have said TLE you are taking stability data you are collecting and you will file and you expect from data filing you expect approval in nine months is that what you say?

Dr. Satyanarayana Chava: The estimate is close to nine months. While we are predicting nine months approval all our API DMFs are reviewed by both US as well as WHO so there is no pending DMF.

Dheeresh Pathak: And TLD approval you are saying you already have?

Dr. Satyanarayana Chava: We have it from global fund and from PEPFAR we expect probably in Q4.

Dheeresh Pathak: How big is this market TLD market of PEPFAR and global fund how many tenders comes out per year?

Dr. Satyanarayana Chava: The global fund is having a meeting in two weeks time and they are going to give the forecast for next year, but we think the market size is ~40 million packs per year.

Dheeresh Pathak: 40 million packs per year and each pack is how much?

Dr. Satyanarayana Chava: It has been about ~$6 per pack.

Dheeresh Pathak: At the manufacture level right?

Dr. Satyanarayana Chava: Yes.

Dheeresh Pathak: Both global fund and PEPFAR put together is it right?

Dr. Satyanarayana Chava: Yes, around that number.

Dheeresh Pathak: TLE market?

Dr. Satyanarayana Chava: TLE market is ~150 million packs.

Dheeresh Pathak: And that also at $6 a pack.

Dr. Satyanarayana Chava: Yes, for calculation you can take that.

Dheeresh Pathak: So what do you think should be your fair share when you start participating in these tenders?

Dr. Satyanarayana Chava: It is difficult to guess right now.

Dheeresh Pathak: In your mind what should be your fair share what you get is not in your hand because it depends upon the people behaviour.

Dr. Satyanarayana Chava: The lion share of the market is with Mylan, Aurobindo, Hetero and Cipla, but we are fully integrated so that is the only advantage we have.

V.V. Ravi Kumar: But we need to keep in mind the approval progress right, so we do not have any full suite of approval, so over a period of time probably in the next one-and-a-half to two years time we will have all the products approval, then it makes sense like maybe in 10, 15 maybe possible.

Dr. Satyanarayana Chava: So the opportunity is big, competition is not that high that is what we can say clearly.

Dheeresh Pathak: When you say do not have the full basket of products each tender is like is a basket tender or each tender is a product specific tender?

Dr. Satyanarayana Chava: Product specific tenders and there is a basket, but you can bid for product.

Dheeresh Pathak: So then that should not impact your ability even though you do not have the full basket approved it should not impact your ability.

Dr. Satyanarayana Chava: You are right. With these two products filed and approved we will be able to participate in tenders worth close to a billion dollar.

Dheeresh Pathak: And in TLE would you have the strongest vertical integration among all the four players, which is already there because I would assume E being your strong part?

Dr. Satyanarayana Chava: Yes we were virtually integrated in all the four products.

Dheeresh Pathak: But the other four competitors would also be vertically integrated in all products not to that extent if we are working, so I am asking in TLE because TLD I do not think you would have that stronger position, but TLE you would have a very strong position would that be a fair understanding?

Dr. Satyanarayana Chava: Yes.

Dheeresh Pathak: So then in TLE you should have the largest market share that should be the fair share in our mind?

Dr. Satyanarayana Chava: We do not want to guess and confuse, but we were giving you the right picture the market size is as we mentioned these two put together close to a billion dollar, we are integrated, we filed one product, we expect to file another product in two weeks, approvals will come during the next financial year and our ability to participate is very high and we leave it at the stage. How much market share we get it is difficult to predict right now.

Dheeresh Pathak: 150 million packs of TLE the entire market opens up every year or is it like a three year, four year?

Dr. Satyanarayana Chava: Every year.

Dheeresh Pathak: Every year the market comes up for renewal?

Dr. Satyanarayana Chava: Yes close to that.

Dheeresh Pathak: Is there a particular month?

Dr. Satyanarayana Chava: No there will be tens of tenders every year.

Dheeresh Pathak: What you bought from Dr. Reddy's that was one off right how much did you pay for that those 11 products?

Dr. Satyanarayana Chava: Two ANDAs were transferred back whereas we paid license development fees back to Rising Pharma.

V.V. Ravi Kumar: For clarification sake, only five products have been taken back and the rest 6 products have not been initiated. So for the five products with Dr. Reddy's and Rising Pharma roughly around INR 4.5 Crores has come as a hit in Q2.

Dheeresh Pathak: So that is one off R&D cost apart from the regular A&D filing?

V.V. Ravi Kumar: Yes absolutely right.

Dheeresh Pathak: Then what you did with the Chinese company on Tenofovir so who sells in the US market, he sells in the US market the manufacturing margins or what how does it work?

Dr. Satyanarayana Chava: We are negotiating, but we will get the rights to market in US with the profit share with them.

Dheeresh Pathak: So although you transferred the ANDA will they market ?

Dr. Satyanarayana Chava: CASI will hold the ANDA rights, but we are negotiating to market.

Dheeresh Pathak: No in US market he will market and he will give you profit share and manufacturing cost right?

Dr. Satyanarayana Chava: No, we will market and give profit share to them because they are going to hold the ANDA.

Dheeresh Pathak: But basically he is only doing it for the Chinese territory?

Dr. Satyanarayana Chava: Yes right.

Dheeresh Pathak: Because it helps him to get approval there?

V.V. Ravi Kumar: Right you got it.

Dheeresh Pathak: So it does not impact your ability to monetize the US market for yourself?

Dr. Satyanarayana Chava: Yes, fair point and our agreement also allows to file another ANDA beyond a sufficient time, but we do not want to do it because there is no point in developing another ANDA since the opportunity is there for us to market is in same ANDA.

Dheeresh Pathak: Of the total debt how much is forex debt?

V.V. Ravi Kumar: Almost $45- $50 million is the forex debt, dollar denominated debt which is about INR 350 crores.

Dheeresh Pathak: Do you hedge?

V.V. Ravi Kumar: We have an forex policy to keep it open up to $60 million both trade and the debt so beyond $60 million we hedge.

Dheeresh Pathak: So if you are saying your forex exposure goes beyond 60 million then you will hedge?

V.V. Ravi Kumar: Yes.

Dheeresh Pathak: So right now it is below that you have not hedged?

V.V. Ravi Kumar: Yes we have not hedged. We would have hedged something so it is not that we do not hedge at all. Whenever it crosses that limit we hedge, but we are seriously looking at this current rupee depreciation whether do we need to reduce the limit? But we will not take any action at this moment; we will wait and watch that if the rupee is getting normalized much below 70/$ at the time we will think to reduce the limit.

That is one and second is whatever revenue growth we are envisaging from formulation and the contract manufacturing those are all billed in dollar denominated contract, so in future our

revenue growth in forex will be much higher so that automatically your exposure will come down.

Dheeresh Pathak: And capex for this year and next year?

V.V. Ravi Kumar: This year we are expecting to do it around INR 250 to 300 Crores that is what we said and for the next year we have not yet crystallized, but it will be a lesser number.

Dheeresh Pathak: So where is this 300 Crores this year going into.

V.V. Ravi Kumar: This year the it includes the Lamivudine block and the oncology block expansion also happened in Unit III which is already being done in the H1 which is about INR 150 Crores roughly and another INR 150 Crores goes in PMPA block and the contract manufacturing API block and then other balance for equipment.

Dheeresh Pathak: In FY2020 then it will be just maintenance capex?

V.V. Ravi Kumar: Maybe INR 50 to 100 Crores could be, it is not maintenance capex, but total capex could be that kind of a range, but we are not crystallized yet.

Dheeresh Pathak: Thank you.

Moderator: Thank you. The next question is from the line of Rajdeep Singh from ASK Investment. Please go ahead.

Rajdeep Singh: Thank you my questions have been answered.

Moderator: Thank you. The next question is from the line of T Srihari from PCS Securities. Please go ahead.

T Srihari: If I get it right you said that for the formulations business you expect the gross margins next year to cover your opex is that right?

Dr. Satyanarayana Chava: FY2020 probably yes.

T Srihari: And secondly on the R&D front you already have a base of around 800 R&D scientists spread over several centers and you are setting up another one at Vizag so can you please throw some light on this to give some clarity?

Dr. Satyanarayana Chava: Our Vizag R&D expansion is to boost our efforts towards backward integration. We do not have too many people right now, but the center can accommodate up to 150 scientist, they will focus more on starting meters and intermediate to have more control on supply chain. So the total number of R&D maybe in 24 months from now could reach 1000 from 800.

T Srihari: But on the scale basically this will be should I say a little bit lower on the complexity front?

Dr. Satyanarayana Chava: I did not get you?.

T Srihari: I was trying to work out let us say the costing for let us say 200 extra scientists will it be greatly different from 800 that are already there on our rules?

Dr. Satyanarayana Chava: Yes.

T Srihari: Got it. Thank you.

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

Tushar Manudhane: Sir I just to understand this TLE, TLD formulation business will that have cannibalizing in fact on the ARV, API business?

Dr. Satyanarayana Chava: Definitely not because we are not using any of our capacity selected for API sale into our formulations. We are using excess capacity or newly created capacity for the formulation business and in APIs if we supply on time at the market price we do not expect any cannibalization.

Tushar Manudhane: So the single digit growth what you are guiding for that remains on the ARV, API side and then the formulation ARV business will be incremental?

Dr. Satyanarayana Chava: Absolutely and whatever APIs we used in our formulations we are not considering as a same in our API business anyway.

Tushar Manudhane: And on the formulation side we have now with this validation batches getting complete for TLE, TLD and then this end percent of the capacity committed for a customer the formulation revenue will it be sufficient enough to achieve the breakeven?

Dr. Satyanarayana Chava: FY2020 definitely we expect to breakeven.

Tushar Manudhane: Given that the operational expense remains at?

Dr. Satyanarayana Chava: INR 150 Cores yes.

Tushar Manudhane: Thanks a lot.

Moderator: Thank you. That was the last question of the conference. I now hand the conference over to the management for closing comments.

Dr. Satyanarayana Chava: Before we conclude the call, I would like to share one information which is, just now we concluded USFDA inspection for unit VI in Vizag and we had one observation, which is very procedural on the method development and validation. We will share the press release right now, it was a very good audit for us. Thank you.

Moderator: Thank you. On behalf of Kotak Securities we conclude this conference. Thank you for joining us. You may now disconnect your lines.