



“Neuland Laboratories Limited Q1 FY-17 Earnings Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to the Newland Laboratories Q1 FY17 Earnings Conference Call. As a reminder, all participants' lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' on your touchtone telephone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Diwakar Pingle from Christensen IR. Thank you and over to you, sir.

Diwakar Pingle: Welcome everyone and thanks for joining the Q1 FY17 Earnings call for Neuland Laboratories Limited. Please note that the results have been made to you and you can also view this on our website at www.neulandlabs.com.

To take us through the results for this quarter to answer your questions we have with us the management represented by Mr. Sucheth Rao, Vice Chairman & CEO; Mr. Saharsh Rao, Joint Managing Director and Anil Kumar who is the CFO.

We will be starting the call with a brief over view given by Saharsh providing a brief of the company's performance which will then be followed by Q&A session.

I would like to remind you that everything said on this call may reflect any outlook for the future or which can be constitute as a forward-looking statement. It must be viewed in conjunction with uncertainties and the risks that we face. These uncertainties and risks are included but not limited to what we have mentioned in our prospectus filed with SEBI and subsequent annual report which you can find on our website.

With that said, I will now turn the call over to Mr. Saharsh Rao. Over to you, sir.

Saharsh Rao: Good morning everyone. A warm welcome to all of you who have logged on to this call. Let me start with the financial first and then move onto some business highlights. For the quarter of Q1 FY17 the total operating income was Rs. 149.77 crores compared to Rs. 123.72 crores for the same quarter last year representing an increase of 21%. The EBITDA stood at Rs. 25.05 crores compared to Rs. 21.63 crores for the same quarter of FY16, an increase of 16%.

The EBITDA margin is at 16.7% for Q1 FY17 as against 17.5% for Q1 FY16. Net profit stood at Rs. 9.71 crores for the quarter as compared to Rs. 7.3 crores for Q1 of last financial year. Basic EPS stood at Rs. 10.93 crores as against Rs. 8.22 crores in Q1 of FY16. If I have to quickly dissect the results the key highlights would be our revenues have been the highest in the quarter in the history of the company and that is positive. The EBITDA margins are stable but you must understand that the same is the function of the product mix and hence the same has been constant compared to last quarter. When we compare the EBITDA of this quarter with the Q1 of last fiscal there is a difference due to onetime payments that Neuland received from APIC which were a part of other income in Q1 FY16.

Other highlights from a business mix perspective about 47% of revenues came from prime products, 29% from niche API and the remaining 23% came from CMS business. You would recall that starting from last quarter onwards management has decided to give the business saliency information as well and this breakdown that I just shared is a part of that initiative.

The CMS business also has another highlight continues to see improved traction and from a project perspective the company is currently working on about 10 projects; 9 in Q4 of FY16 and 1 in Q1 of FY16 of which 6 are in commercial stage and 4 are in clinical stage. From an operational perspective some of the key highlights include successfully cleared ANVISA audit for the unit 2. This is the regulatory agency from Brazil. Also continued business momentum in Salmeterol one of the products that we have been talking about as it gets commercialized. We have added new customers as well as penetrated new markets for this product. Then progress in new GDS API called Deferasirox with addition of new customers and initiation of supplies for validation batches in multiple geographies and also another highlight would be encouraging initial response from the Chinese pharmaceutical markets where we have initiated sale of several new APIs.

So to summarize I think this was a very strong quarter in terms of financial performance as well as the operating parameters. We believe that this momentum will build as we move forward and are cautiously confident of the growth prospects of the company for the financial year.

Having said this, I would like to now throw open the floor to Q&A. Sucheth, Anil and I will try to respond as much as we can. Over to you, Diwakar.

Moderator: Thank you very much, sir. Ladies and gentlemen, we will now begin the question-and-answer session.

We have the first question from the line of Abdul Puranwala from Centrum Broking. Please go ahead.

Abdul Puranwala: My first question is regarding the revenue growth. So in Q4 you have stated that there was one deferred order which has been passed on to Q1 that is the current quarter. So can you tell me what would be the actual growth barring that one particular order?

Saharsh Rao: Abdul, I think there was a reference made in the previous quarter that there have been some orders which were not fulfilled at the end of Q4 and those would be spilled over to Q1. I think you are referring to that comment, is that right?

Abdul Puranwala: Yes, sir.

Saharsh Rao: So I think it is fair to comment, Abdul, that in our business there are always going to be orders, deliveries certain products which are going to fall towards the end of the month or end of a

quarter and invariably it is beyond operations control as to when it will get billed. So to answer the question specifically would be very difficult because to be honest we would continue to have those kind of spillovers of opportunities in our normal business. So for example there would be orders in Q1 also which we may have originally plan to have delivered in Q1 but may have spilled over to Q2. So in summary it is not really prudent to look at the impact of that because the growth that we have achieved we believe is a realistic fundamental growth.

Abdul Puranwala: And my second question would be regarding the Salmeterol, so which new geography have we introduced Salmeterol?

Saharsh Rao: So these customers are customers within the European region, Abdul, these are probably second tier customers who are going for late launches and they are different countries within Europe as well as other regions.

Abdul Puranwala: And so for FY18 we had given previously a revenue guidance of Rs. 750 crores so do we still maintain that?

Saharsh Rao: We have actually never given revenue guidance, Abdul, so not sure where your comment is coming from.

Moderator: Thank you. Next question is from the line of Hareesha Kakkera from BOB Capital Markets. Please go ahead.

Hareesha Kakkera: I just wanted to know what is the growth rate in Salmeterol that you have achieved and going ahead what could be the growth rate?

Saharsh Rao: Thanks for the question. We actually have not disclosed growth rates especially within the product individually. So that is a question that we would not be able to answer.

Hareesha Kakkera: And I just wanted to know like which phases of the molecules are you concentrating right now, it seems that it is more of Phase-2 and Phase-3 and are you continuing the same going ahead?

Saharsh Rao: So typically our approach in this CMS business, Hareesha, is to look for opportunities which are in Phase-2, Phase-3 because that is the right time for us to partner as a contract manufacturing organization. But the way we actually visualize our business is that molecules will continue from Phase-2 to Phase-3 and commercialization so over time the number of commercial opportunities will increase. So that is the model that we are pursuing. Having said that we do pursue opportunity directly in commercial as well. So sometimes we do talk to pharmaceutical companies who already have a commercial molecule and are looking for a second supplier or a third supplier where Neuland tries to go and enter that role. So there is no clinical part of development over there where we become directly part of the commercial.

- Hareesha Kakker:** And what are the new geographies you are tapping for the CMS business?
- Saharsh Rao:** CMS typically we focus on Europe, North America and Japan these have been predominantly our three main regions. On top of that we do also actively look for opportunities with Indian pharmaceutical companies as well. But obviously we have different criteria within these markets which I perhaps may not be able to elaborate because of the time limitations.
- Moderator:** Thank you. Next question is from the line of Amish Kanani from JM Financial. Please go ahead.
- Amish Kanani:** Can you give us some flavor of what type of products are we selling under the niche API given the confidentiality you may not be able to name all of them, but if you can just give us what type of API we are designing as niche, one. And two, what kind of margins are we getting from that say vis-à-vis a blended margin that we have for their business? And third, if you can just also elaborate on this surplus land agreement how much is the land and some flavor on that?
- Saharsh Rao:** With regards to niche generic APIs these are typically molecules which are differentiated either because of the method of use of the products. So they are typically they are injectable, APIs are going to injectable formulation, APIs are going to trans dermal patches or into inhalation products etcetera or another way of defining a niche API would be molecule which is extremely complex in nature where chemically it is very challenging to manufacture it. What it means from a market point of view for a niche generic APIs is that the market itself may not be very large but the opportunity for a company like Neuland to penetrate that market and gain a significant market share would be quite high.
- So typically niche generic APIs would not be very large in terms of turnover topline, but very high in terms of margins as well as the market share opportunity for Neuland itself. And we have given examples of molecules like Salmeterol, Propofol in the past. There is a molecule called Deferasirox which we talked about in this release. We talked about Paliperidone in the past. These are all examples of niche generic APIs. And with regards to margins we would not like to comment specifically about the margin profile of niche generics but as I mentioned in my earlier comment these are typically higher margin products compared to our prime products. So therefore we expect them to contribute positively to the margin of the business.
- And then finally with your question about Nanakramguda, the property that is being developed with Phoenix this is actually a joint development agreement. So Neuland actually does not contribute to any investments into this project this land actually is located in one of the developing parts of the city where a lot of corporate offices are coming up and the developer would actually build office space which would be shared in the ratio of 23% to 77% approximately. And it is from Neuland's point of view, it is a very positive development because without any further investments other than what we have done in the past, we will be able to acquire 23% of share.

- Amish Kanani:** So what was the land in terms of acres or square feet sir, if you can share that?
- Saharsh Rao:** It is a five-acre plot.
- Amish Kanani:** And sir, can we assume that the niche generic, we have a EBITDA margin in the range of 17%, 17.5%. So can we assume that niche generic would be say more than 25% margin?
- Saharsh Rao:** It really depends on product-to-product so it would be hard to comment on that.
- Moderator:** Thank you. We take the next question from the line of Tushar Mundhane from Anand Rathi. Please go ahead.
- Tushar Mundhane:** With respect to prime segment, I just would like to understand the volume growth and the pricing growth for the quarter?
- Saharsh Rao:** So I think within the quarter the prime products have contributed to about 47% of our top line which you would imagine is close to about Rs. 70 crores, Rs. 72 crores. So this is actually largely driven by about five or six products which are part of the prime category. Within these products we have not really given specific breakdown of products itself. But in terms of general trends it is hard to comment on volume as well as pricing trends together as a group because there are products where there is a declining trend of pricing, there are products where there is price stability and there are products where price is also increasing.
- Management:** But generally overall we do expect that the revenue growth from prime products will not be aggressive, it will always be a modest growth because those are products where we have already established our market share where the product itself is not growing significantly.
- Tushar Mundhane:** API kind of legacy, API kind of business and say let us say a couple of companies because of the oil based products with the fall in crude oil prices and all there has been sharp reduction in prices for them because of subsequent fall in the raw material prices. So is that effect seen in our case also?
- Management:** No, so when we say prime products we are actually referring to Neuland's products, right. Prime does not mean that they are actually commodity APIs. So prime products for us might actually be very good products for somebody else. So I think we are reasonably insulated from our margins being significantly impacted by crude oil prices. I think that macro fluctuation in these commodities impact the price of our solvents and some other smaller materials. But I do not see that they will have a huge impact on the margins of our prime APIs.
- Tushar Mundhane:** And my second question is with respect to the sequential drop in gross margin, if you can help me understand that?

Management: So I would encourage you not to read too much into a quarter to quarter change in the gross margin or a slight change in the EBITDA margin because that will it is a product with which impact that and you will see that fluctuation on a quarter-to-quarter basis.

Tushar Mundhane: Because sequentially also we have seen the improvement in the sales contribution from CMS and niche segment despite that we are having the falling gross margin that is the reason why the question?

Management: Tushar, again gross margins for the quarter is about 53% whereas for the full year of last year it has been slightly lower, it is about 51%. So for the quarter it is okay, it is fairly compared on an annualized basis of last year it is okay. It is in line with that or slightly better.

Moderator: Thank you. Next question is from the line of Ashish Rathi from Infina Finance. Please go ahead.

Ashish Rathi: I just wanted to understand if you can we treat this like a base quarter and going ahead can we assume that we will see growth from here onwards, on these numbers?

Saharsh Rao: So I think as I mentioned earlier we think that the growth that we have achieved is a fundamental growth. And I think the journey in our business is such that every quarter has a different characteristic to it. So we cannot help you with a clear definition. But I think hopefully that should give you enough clarity.

Ashish Rathi: Okay and secondly on the margins that the top line is growing good and the margins we have still in the band of like 15% 20% odd. We have been indicating around 20%. So should we like will we be looking as an inflection at some point in time or how should we look at the margins trajectory going forward? I mean when do we see actually a continual improvement happening or should we wait for an injunction?

Saharsh Rao: I do not think there will be an inflection itself, Ashish, but it will be a gradual ramp up in margin as you know the margin the business mix changes and continues to improve as well as operational leverage kicks in. So we are able to generate more turnover from the same facilities. The combination of these two factors will actually drive the margins. When we will get to a certain milestone is really dependent on how and when we execute the business mix. So it is hard for us to comment on that but I can tell you that there will not be any inflections, it will be a gradual move and it will not be a linear move as well.

Ashish Rathi: Just to add to that in terms of the debt position where are we right now and how should we see this going ahead, the debt number?

Saharsh Rao: The debt position if you see it is about almost like Rs. 175 crores. It is in terms of net worth we are about Rs. 195 crores. So it is lower than one. The long term debt is about Rs. 45 crores and the short term debt is about for the working capital requirement is about Rs. 130 crores.

- Ashish Rathi:** So do we intend to repay this debt or how do we look at it? Will there be raising further debts or CAPEX will we need that? How do we keep the debt system moving for the company's basically?
- Saharsh Rao:** See if you look at the CAPEX position for the company we said in the last quarters saying that the CAPEX for the year is about close to about Rs. 22 crores and we would be largely funding it through internal accruals.
- Management:** And in addition to that just an additional comment is see our goal is to keep debt always at a healthy level. Currently our debt equity is less than 1 so up to about 1.5 to 2 times is considered reasonable and not too risky. So we will always like to keep our debt equity at a very healthy level. Working capital will always be around 30% of our overall sales, 28% to 30%. So going forward that is how we would like to maintain. Of course there will be changes based on requirement. It will be up and down but you will see that it will always be maintained at these levels.
- Moderator:** Thank you. The next question is from the line of Saravanan Viswanathan from Unifi Capital. Please go ahead.
- Saravanan Viswanathan:** I would like to know if Evolve has exited from the parent company or they are still the shareholders?
- Saharsh Rao:** I think this question has been asked in the previous calls as well. Now since that is a transaction that is happening in the holding company we will not elaborate on it but the process is going on. So it is not yet complete.
- Saravanan Viswanathan:** Okay and in terms of the real estate you had mentioned that it is pertaining to office space, during this quarter have we received any specific income from this arrangement in terms of some initial fee or something?
- Saharsh Rao:** No, nothing.
- Saravanan Viswanathan:** And my last question. So can we assume that we have moved from the Rs. 120 crores base to Rs. 140 crores base in terms of quarterly revenues?
- Saharsh Rao:** That is your assumption to make I have actually just mentioned to one of the previous participants that I think this growth is a fundamental growth. But having said that we always have challenges as a business. But we are quite optimistic about the business going forward as well. But we do not want to give any specific guidance in terms of what is the base.
- Moderator:** Thank you. Next question is from the line of Ayush Surana from Ethos Capital. Please go ahead.

- Ayush Surana:** I just have one question to ask. Have we tied up with an Israeli firm for API contract, are we supplying to them?
- Saharsh Rao:** We cannot comment on any specific products so I am sorry I will not be able to answer that.
- Moderator:** Thank you. Next question is from the line of Amish Kanani from JM Financial. Please go ahead.
- Amish Kanani:** I had a question about given that niche proportion of the business this quarter is reasonably higher than the last quarter same time, still our EBITDA margins are in the same range. So what would you attribute it to? So the question is given that prime is lowering and still our margins are in this range, what do we take apart from say product mix which might be the explanation?
- Saharsh Rao:** I think in terms of the margins itself it is a factor of multiple it is actually a combination of multiple factors. So while the niche generic APIs has increased there are many factors that totally impact the margin of the business. So it will be hard for us to give you any kind of firm factor as to why the margin has not improved. I think I will go back to my previous comment to say that as the business mix continues to increase and the operational leverage continues to increase which means that as we continue to generate more revenue from our facilities we anticipate that the margin will continue to increase.
- Amish Kanani:** Sir, in that context what is our operational capitalization if you were to kind of put some number there?
- Saharsh Rao:** So we believe that our facilities together we operate two manufacturing facilities they put together with some maintenance and debottlenecking CAPEX we would be able to generate Rs. 750 crores to Rs. 850 crores of revenue given an optimal business mix. And this is something that could change plus or minus but that is something that we think is possible from our existing facilities.
- Amish Kanani:** So you are saying in that level the margins will improve is what you are saying?
- Saharsh Rao:** Yes.
- Moderator:** Thank you. Next question is from the line of Vishal Singhania, Retail investor. Please go ahead.
- Vishal Singhania:** Sir, you had said in the last conference call that you expect to reach full capacity by FY17. So do you still stand by that?
- Saharsh Rao:** We have not mentioned that we would reach full capacity by FY17, we have actually said that we would have to continue to augment capacity. And as a part of that Anil had also mentioned in an earlier comment that we will be doing some level of debottlenecking capacity creations within the two facilities.

Vishal Singhania: Okay sir and the next question is sir, Teva Pharmaceuticals from the US said that they would be launching the Huntington disease drug in the second half of financial year 2017, in the second half of 2017 that is. So do we expect some kind of growth coming in from there as we supply APIs for Huntington series?

Saharsh Rao: So we have actually not mentioned specifically which customers we are working with for which products so obviously this is a question that I cannot answer.

Moderator: Thank you. Next question is from the line of Sri Srihari from PCS Securities. Please go ahead.

Sri Srihari: Two questions basically. If you talk about the complex generics space I would like to know what are the meaningful opportunities, you are looking out for over the next 18 to 24 months? And secondly on the custom manufacturing side you mentioned for six commercial molecules you are trying to make an entry there. So what is the kind of market share you might have gained in those products?

Saharsh Rao: So with regards to the niche generic APIs right now a lot of products comprise this category so we have talked about Salmeterol, Paliperidone in the past molecules which are a part of this category. I think going forward we will continue to strive to launch more products in this category and as a result we will hope to commercialize more of them going forward. One of the products I mentioned in today's call in my opening comments was Deferasirox which is a molecule again which is a part of this category, very interesting product for which we are looking at global market share.

This is a molecule whose patent expires in 2019. Again we will not have the time to elaborate a lot of products but there are other molecules as well such as Propofol, Escitalopram, Sugammadex, Donepezil etcetera which are all part of this category and will continue to have good opportunities for Neuland going forward. There is also a product called Labetalol which we mentioned in our earlier updates as a molecule. That is an old molecule but is being scaled up. Labetalol is also an example of a niche generic API wherein Neuland is actually trying to create a very good market opportunity for a molecule that actually has been generic for quite some time.

Sri Srihari: And what about Lurasidone?

Saharsh Rao: That is a molecule which is part of our product list, it is still under development. I believe it is still early to comment on the prospects of it. But we are doing the validation for that molecule this year.

Sri Srihari: And regards to the six custom manufacturing products that you mentioned?

- Saharsh Rao:** With regards to these molecules obviously these being our custom manufacturing molecules we cannot delve into any details of these products. But again our strategy with regards to these products are varying it could be in some cases where we are the prime and only API supplier. There are cases where we are the secondary supplier but with a greater than 50% share and there are also cases where we are the secondary supplier with a less than 50% share. All these scenarios are quite possible. But what I would also like to say is that in most of these molecules we are always the API supplier. There are not a lot of projects where we are in the intermediate business.
- Sri Srihari:** Right so I mean how would you position yourself in this I mean basically are you at let us say are you kind of satisfied with the market shares you have or there is still a lot of scope to go?
- Saharsh Rao:** It is a continuous process and I think we would like to keep increasing our market shares for these molecules. I would say we would never be satisfied with what kind of a share we have. But again it really depends on the specific molecule itself because ultimately when we are in the contract manufacturing space we typically do not offer those molecules to the generic customer. So we are working only with the innovator company exclusively.
- Sri Srihari:** Okay and because the four in clinical stage are they in late Phase-3?
- Saharsh Rao:** So they are in Phase-2 as well as Phase-3.
- Sri Srihari:** Okay and can you give some addressable market size for these four products?
- Saharsh Rao:** It would be hard to do it at this moment because we typically do not try to frame market size for these molecules which are still under clinic because one the data itself is not very clear and available. Second of all there are still a lot of uncertainties that involve before we can actually achieve that market.
- Sri Srihari:** So at least the therapies to which these four belongs?
- Saharsh Rao:** There are actually in there are a couple in CMS space. There is one in cardio vascular and there is one actually which is an antibiotic.
- Moderator:** Thank you. The next question is from the line of Saravanan Viswanathan from Unifi Capital. Please go ahead.
- Saravanan Viswanathan:** I would like to know the filing pipeline what kind of and how many DMFs are we likely to file this year and what is the existing filings?
- Saharsh Rao:** So we intend to develop 12 to 16 APIs in FY17 for which obviously our strategy would be to file DMF, CEPs as well as various other filings including IDLs if it is the Chinese market. But

at this point of time we are not very clear in terms of which products will get filed this year or not. But you can take it that we intend to scale up about 12 to 16.

Management: And this includes the CMS APIs as well. So we are talking about the total number of APIs. So some of them may not even have a DMF and that is why it is difficult for us to comment the exact number of DMFs.

Saravanan Viswanathan: And as regards to CMS can you broadly give a geographical mix?

Saharsh Rao: So CMS it is still a growing business for the company and therefore the year-to-year mix could depend on which specific projects we are executing. But broadly in a steady state it would be currently about 40% US, about 30% in Europe and about 20% to 30% from Japan.

Moderator: Thank you. Next question is from the line of Hareesha Kakkera from BOB Capital Markets. Please go ahead.

Hareesha Kakkera: Sir, I wanted to know like somewhere in your Annual Reports you happened to mention like on an average you are going to add 10 to 12 products to the product basket every year. And I want to know what percentage of it would be high value the niche molecules and what percentage it could be for the CMS?

Saharsh Rao: So Hareesha, generally speaking it has been the management philosophy to shift the business strategy from being a prime focused organization to a niche focused organization because ultimately we believe that niche is where Neuland's capabilities are better utilized. And there are greater opportunities where we are facing less pricing pressure or less pressure from competitors in this niche generic space. So as a part of our strategy we have made this conscious move to focus more on niche generics.

So as a result of this strategy a lot of the focus on the development molecules have been these niche generic APIs and therefore to answer your question it could be envisaged that a significant part or a major part of these molecules would be niche generic APIs. However, there would always be a possibility for us to develop prime APIs if they present the right opportunity and if Neuland can come up with the right technology that gives us that leadership.

Hareesha Kakkera: So can we assume like it could be around 80% of the new additions would be niche molecules?

Management: Well it is tough to comment on an exact percentage Hareesha because that will keep changing maybe you could say that one third will still continue to be molecules which would eventually become prime. Because a lot of our customers, our old customers keep asking us to develop those molecules. Another third would be niche and another third would be probably significantly more niche. That is typically how our product portfolio will look like.



*Neuland Laboratories Limited
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Moderator: Thank you. As there are no further questions from the participants, I would now like to hand over the floor to Mr. Sucheth Rao for his closing comments. Over to you, sir.

Sucheth Rao: So thank you everyone. I thank you for taking the time to joining the call. Again in summary we believe that this quarter was a good representation of the growth that we have achieved over the year. I think going forward we continue to have optimism about our baseline business which is the prime product as well as the Niche Generics as well as the CMS business. We will continue to have these interactions in our quarterly investor calls. And in the meanwhile should you have any questions or clarifications, please do reach out to our investor relations agency, Christensen. I would also like to add thanks to Christensen as well as all our other members who have actually supported this conference call. Looking forward to our future interactions.

Moderator: Thank you very much, sir. Ladies and gentlemen, on behalf of Neuland Laboratories, that concludes this conference call. Thank you for joining us and you may now disconnect your lines.