



“Neuland Laboratories Limited
Q3 FY18 Earnings Conference Call”

February 02, 2018



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*Neuland Laboratories Limited
February 02, 2018*

Moderator: Ladies and gentlemen, good day and welcome to Neuland Laboratories Limited Q3 FY18 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. Diwakar Pingle from Christensen IR. Thank you and over to you, sir.

Diwakar Pingle: Thanks, Mallika. Welcome and thanks for joining the Q3 FY18 earnings call of Neuland Laboratories. Please note that we have emailed out the press release to everyone and you can also see the results on the website as well as the stock exchanges. To take us through the results of this quarter and answer your questions, we have with us from the Management - Mr. Sucheth Rao, Vice Chairman and CEO; Mr. Saharsh Rao, Joint Managing Director; Mr. Amit Agarwal, who is the Chief Financial Officer. We will be starting the call with the brief overview of the quarter gone past by Saharsh which is then be followed by overview of the financials given by Amit, which will then be followed by Q&A session.

I would like to remind you that everyone that everything said on this call which reflects any outlook for the future or which can be construed as a forward looking statement must be viewed in conjunction with the uncertainties and risks that we face. These uncertainties and risks are included but are not limited to what we have mentioned in the prospectus filed with SEBI and subsequent annual report which you can find on the website. With that said, I will now transfer over the call to Saharsh. Over to you, Saharsh.

Saharsh Rao: Thank you, Diwakar. Good evening friends. A warm welcome to all of you joining this call. Let me first provide an insight into our operating performance during the quarter, post which Amit will take you through the financial performance. This quarter has continued to be a muted quarter with no letup in the issues that have impacted the previous 2 quarters as well. Revenue was low in some of our GDS as well as our CMS products. We are seeing some signs of recovery in Q4 in some of the key products including Ciprofloxacin and CMS products and that gives us a lot of confidence about how things are going forward. The Company is taking steps to reduce cost and sustain margins by focusing on yield improvements and production efficiency in order to offset pricing pressure for some of our prime products. We have already started seeing the benefits coming and will continue to extend into our future.

During the first 9 months of the year, the key reasons for decline in our performance has been stock accumulation at our customers' end and hence lower offtake. Capacity imbalance between our two manufacturing units and some regulatory delays for some of our key products which prevented us from selling more during this period. All of these issues seem to be now gradually easing out. During this quarter, the Chinese FDA has successfully completed its audit. We have filed a US DMF and CEP for Aripiprazole Anhydrous which is a GDS product. We have also scaled up one CMS product and one GDS product Aripiprazole Lauroxil this quarter and all these should be adding to our near-term mid-term growth plan.

Important highlight that I would like to present before the investors is that we have completed all the formalities with respect to the acquisition of Unit 3 from Arch Pharma Labs Limited in December 2017. The facility is spread across 12 acres and has a capacity of about 197 kiloliters. It approximately represents a 40% increase in terms of total manufacturing capacity for Neuland. It is a multiproduct facility and has 5 production blocks for API manufacturing as well as advanced intermediate manufacturing. It also has capability for onsite development, analytical method development, quality control laboratory and a pilot plant.

To start with, Unit 3 would immediately serve as a backward integration facility for a number of products that we currently manufacture apart from derisking raw material supplies for existing products. It also gives the company flexibility to add new high-volume products while creating additional capacity for new CMS products as well as doubling up as an alternate site for existing products. At this moment, we are in the process of identifying the products that will be manufactured from here and we will be able to give you more colors on products and revenues from the facility as we move into FY19.

We are sure of getting Unit 3 to become operational over the next 100 days. This will ensure that the unit is not a significant strain on our financials. We are quite excited by this acquisition. It is a reflection of the Company's strategic direction and investment in this facility will also set us up nicely for future growth prospects.

As was the practice from the last quarter, we have also provided you with the CMS pipeline and the numbers are self-explanatory. In case you have any specific questions on the table, we are happy to take up during the Q&A session. I will now request Amit to run through the financials.

Amit Agarwal:

Thanks, Saharsh and good afternoon everyone. I will first focus on the standalone 9 months numbers and then take you through the quarter highlights. Standalone 9 months FY18 numbers: total revenue stood at Rs. 363 crores for 9 months as compared to 438 crores for 9 months FY17, a decrease of about 17%. EBITDA stood at Rs. 39.2 crores compared to 65.6 crores during the same period in the previous year, down by 40%. EBITDA margin at 10.8% for 9 months FY18 as compared to 15% for 9 months FY17. Net profit stood at Rs. 6 crores for 9 months FY18 as compared to Rs. 23 crores in the same period last year. Diluted EPS stood at Rs. 6.87 as against 26 in 9 months FY17.

For the quarter numbers: total operating income was Rs. 117 crores for Q3 FY18 as compared to Rs. 134.9 crores in the corresponding period of the previous year, reflecting a decrease of about 12%. EBITDA stood at Rs. 11.2 crores as compared to 15.5 crores during the corresponding period of the previous year, a decrease of 27%. EBITDA margin was at 9.6% for Q3 FY18 as against 11.5% in Q3 FY17. Net profit stood at Rs. 1.2 crores for Q3 FY18 as compared to 3.6 crores in the corresponding period of the previous year. Diluted EPS stood at Rs. 1.36 crores as against Rs. 4.09 in the corresponding quarter of the last fiscal.

I would like to hand it to Sucheth to summarize the quarter and then we will move to the Q&A session.

Sucheth Rao:

Thanks, Amit. I believe Harsh and Amit have captured all that we had to do, but if I had to quickly summarize the quarter and how the business has panned out, the year so far has definitely seen a dip in the GDS as well as CMS revenues especially owing to Ciprofloxacin, Salmeterol and a couple of CMS products; however, we are seeing an uptick in Q4. We have seen the Cipro volumes come back. We are also seeing the CMS volumes come back. So as we anticipated it, it was more of a temporary dip rather than a long-term adjustment of the business. Apart from that, I think given how the year has panned out, we have put a lot of emphasis on cost and operational efficiencies to ensure that we offset any pressure on margins. The benefit of which will also continue in the next financial year.

Our research pipeline continues to be strong. I think we had about 36 molecules at the end of Q2 that is gone up to about 42 molecules. The Unit 3 acquisition as mentioned by Harsh is now complete. In fact, we expect to start scaling up the first product very soon and we are doing everything possible to ensure that Unit 3 contributes to our overall growth as quickly as possible. Having said that, we remain pretty confident about the long-term prospects of the company. Cipro, Salmeterol and a couple of other molecules which exhibited muted growth during the current financial year have started to come back. We have seen the evidence of that in Q4 and we expect that will continue over the next financial year and after that as well.

With that, we can now throw it open to questions and will be happy to take that.

Moderator:

Thank you very much sir. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Rashmi Sancheti from Anand Rathi. Please go ahead.

Rashmi Sancheti:

Just wanted to know when this new facility will get commercialized and also what will be the additional CAPEX spent in FY18 as well as FY19? And my second question is related to the performance in the prime segment and the niche segment - niche segment has shown 29% growth on the low base of Q3 FY17. Is it that really we are seeing Salmeterol incremental quantities pick up in Q3 or that is something which is going to start only from Q4 FY18 onwards. So a little color on that?

Sucheth Rao:

Thanks for your question. Rashmi, as far as our Unit 3 is concerned, we expect to start commercial manufacturing in Unit 3 within the next 100 days or so if not earlier. In addition to that, we have actually got a schedule of products that will be scaled up by this facility so that we can bring it to an optimal level of operation. I think the current anticipated CAPEX to get the unit to function at an optimum level is not more than about 13 to 15 crores at this point. Any additional CAPEX after that will be completely based on the kind of products that we are scaling up here.

Rashmi Sancheti: So for this facility, any additional CAPEX will not be spent apart from whatever you have bought it for?

Sucheth Rao: As stated, at this point of time the figure is a 13-15 crores, but at the same time based on the products either contract manufacturing opportunities or any other product that can be launched on this product. If there is an additional CAPEX that is required, we would definitely bring them, but at this point based on the calendar of products that we are currently scaling up, whatever is mentioned, and the numbers will be consistent with that.

Rashmi Sancheti: You mean to say 15 to 20 crores for both the years FY18 and FY19 currently?

Amit Agarwal: No, I did not say that. I said about 15 crores of CAPEX to get the facility running.. To make sales for the product that we currently anticipate to scale up, further CAPEX will be added based on any new opportunities that comes in this facility.

Rashmi Sancheti: Okay, alright and the second question?

Saharsh Rao: So with regards to the second question, Rashmi about the performance of niche products in Q3 and I think specifically about the situation of Salmeterol, I think Q3 as you rightly observed, the contribution of niche products are in already subdued indicates that this category has not performed the way it has in the past and I think that has largely been driven because our Salmeterol sales continue to be down compared to our expectation. If you recall, what we had said as part of our opening remarks also while we have already begun to see a clear improvement in the situation with regards to Ciprofloxacin, but with regards to Salmeterol, I think we still need to wait for various customers to get approval and that is what will help us eventually be able to bring back the sales of this product. At this point, we still do not have any clear indications from where we stand, but we also feel that the coming year should definitely open up this market for the generics.

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

Ranvir Singh: Sir, first of all have you reclassified the revenue in last quarter because the number I have is showing different proportion of CMS and prime segment. So this press release, the number you have mentioned in this press release is different from what earlier press release said in last quarter FY17? So is there any reclassification or I have not recorded properly?

Sucheth Rao: Ranvir, there has not been any reclassification from our side. So request you to just double check and if not clarify it with Diwakar offline.

Ranvir Singh: Secondly, how many projects currently in CMS which has contributed to revenue?

Sucheth Rao: About 6 projects, Ranvir. We have totally about a cumulative number of 42 projects in the system today, but about 6 have contributed this quarter.

Ranvir Singh: And this fall in CMS revenue, is basically due to because of lesser number of projects or for existing projects, certain order has been deferred. So what is exactly has impacted this number?

Sucheth Rao: The CMS revenue comes basically from 2 factors. One is from the number of projects that we are actually executing and the second is the number of commercial CMS molecules for which we have orders in the quarter. Both these determine the total CMS revenue for the quarter itself. What we have observed Ranvir, is that the number of CMS projects we have executed in the quarter are actually quite high; however, the revenue number has been low because for some of the commercial CMS molecules that we have, the orders we have received have been lower than expected and that is what has dampened the revenue for this segment.

Ranvir Singh: What I see is that every quarter we have been mentioning that few API have been scaled up like last year we have 5 APIs scaled up. So just I wanted to understand of the total scaled up APIs, how many API or product currently generating revenue. How many are in market?

Sucheth Rao: About 45 or so are currently generating commercial revenue, Ranvir, and they obviously have different levels of contribution and we have probably another 15 or so which are in the pipeline.

Ranvir Singh: Of the 15 that are in pipeline which can be expected in next 1 to 2 years?

Sucheth Rao: So for example, I think one of the molecules that we scaled up this quarter was Aripiprazole Lauroxil. Now that is a molecule which is in the pipeline for us. I would consider that to be a part of our pipeline, but going forward based on how the IP landscape unfolds, it will become a commercial molecule for us for GDS.

Ranvir Singh: In revenue across the segments, is it possible to see a part of business which is in regular and part of highly lumpy? I wanted to segregate which part of business is actually giving this lumpy revenue because I see a volatility in CMS and in API also because we are into B2B business. What I wanted to understand is that we must have some firm orders for particular product for a particular period. I wanted to figure out that what portion of business we can expect on regular basis. What is the portion of business where we are not sure that will continue on a regular basis?

Sucheth Rao: That is a good question, Ranvir. The way we classify our business is what we call the prime products where they are well established and been on the market for several years; those are the molecules represent at the business that tends to be less lumpy. The specialty APIs what we call the niche are a combination of molecules which are tough to produce, but at the same time the molecules which are gaining market share and there is a little bit of volatility. Having said that, the industry itself as you know can be quite volatile in terms of approval getting delayed, in terms of warning letters, in terms of regulatory changes, policies of governments. It will be very

hard for us to stick our neck out and say that this kind of business will never be lumpy because lot of it depends on how the markets are developing and all the regulatory actions all of which seen over the last 2 to 3 years that can impact our business. But coming back to Neuland, I think prime products are the ones where we see the least amount of lumpiness. CMS molecules which are already commercialized reached a certain lifecycle are less lumpy, but rest of the business can be volatile.

Moderator: Thank you. The next question is from the line of Job Philip from ICICI Venture. Please go ahead.

Job Philip: Just wanted to know what is the update on the merger and secondly, how much is the debt on the books currently?

Saharsh Rao: I think with regards to the merger, the process of merger of three companies which is NHSP and NPRPL merging into NLL, the merger petition has been filed with the NCLT. This update has been shared one or two quarters ago when that activity was completed. As of now, the status is that it is still pending with the NCLT. What we understand from the NCLT bench in Hyderabad is that the application is being reviewed. There were one or two queries which were raised over the months of September and December which were also responded to. At this point of time, we do not have any outstanding queries from NCLT and that would mean we are hopeful that we will get the order for the merger quite shortly. Once we receive the orders from NCLT, then the next steps would take about 4 to 5 weeks before which we can amalgamate all the three companies.

So only thing I would say that there are no pending queries from NCLT. At this point, we believe that there is no significant obstacle. Coming back to your second question, our total debt currently is about 340 crores including working capital and term loans.

Moderator: Thank you. The next question is from the line of Kunal Mehta from Vallum Capital. Please go ahead.

Kunal Mehta: I would like to congratulate first you in the fact that you have been able to move the revenue mix towards niche products in the last 2-3 years. I just wanted to understand going forward maybe from a year and a half perspective that after acquisition of Unit 3, how would the entire roadmap play out in terms of your three divisions, the core products, niche, and the CMS business. What I am trying to understand is that how... *(question not clear after this point in recording)*

Sucheth Rao: I will try to respond to the question that I could understand and then gentleman can get back into the queue if he feels it is not answered. The question the way I understood is that the Unit 3 acquisition, how does it impact the strategy of the business with regards to the three subsegments that we have and how would they unfold as we integrate this facility. What I would like to say and what we said in the past also is that our business is comprised of the prime, niche and the

CMS business. Each of these segments have different attributes. The prime business is relatively larger volume business which has relatively more competition, but still relatively very attractive products for us and products that we are focusing on which gives us a very strong base. The niche products are complex generic APIs which give us opportunity for getting into extremely special formulations, give us the ability to be relatively indispensable to the customer and the CMS business of course you all understand is more exclusive business with innovators.

We have also mentioned in the past that the different businesses have potentially different growth rates which is based on the opportunity that exists and the size of the business. As you know the CMS and the niche businesses are relatively smaller part of the business today and that is where there is a lot of opportunity and headroom for us to grow and therefore those tend to have higher growth rates. So that is where we anticipate having relatively higher growth rate. With regards to your question about how the Unit 3 acquisition would impact the strategy itself, as we mentioned in the opening remarks, we look at Unit 3 as an opportunity for us to increase our capacity immediately almost by 40% and possibly by more and it is something that will help us increase our API volumes so that we are able to grow the business beyond what we have mentioned earlier beyond the 750-800 crore revenue. But I think we have also mentioned as an immediate step we are looking at Unit 3 acquisition as a means for backward integration so that that could help us position ourselves more strongly with regards to being able to produce our own starting materials which we currently either import from China or we buy from high cost suppliers and that would in turn help us improve our overall margins. Besides that, we think that the Unit 3 will continue to support the strategy which is to grow all the three segments of the business, niche, prime and CMS and where it would add value is to be able to provide readily with capacities and also in certain cases provide us with certain technical capability. For example, there are certain kinds of reactions that can be handled in Unit 3 which means that we will be able to pursue some new molecule and new CMS opportunities as a result of that.

Moderator: Thank you. The next question is from the line of Avinash Mansurani who is an individual investor. Please go ahead.

Avinash Mansurani: Sir, there are couple of questions. One is reading on annual report, you had a JV earlier and then you had acquired the unit of that JV. So what the status is of that currently because is that the Unit 3 or is the Unit 3 we want that you have acquired from the JM Financial deal. This is one question I have.

Sucheth Rao: Thanks, Avinash. We had discussed that in the earlier calls. That was a production block within our Unit 2 facility that we have built for the sake of this JV, but what we ended up doing is we end up acquiring that production facility back and it has become part of Neuland's capacity and Neuland's books. Unit 3 acquisition is an entirely new facility that we acquired recently.

Avinash Mansurani: And the last question was you have also mentioned earlier on the call that you have a product that you want to look at Unit 3 for, so at peak capacity what could be the incremental turnover?

Sucheth Rao: What we have done Avinash is based on our strategic business plan, we knew that we would need to acquire significant capacity in FY18. So the acquisition of this additional facility was in line with our plans which would actually be mentioned in our calls as well. We do not expect Unit 3 to specially contribute to any additional revenues, but it is in line with what revenue growth we expect it to begin with.

Moderator: Thank you. The next question is from the line of Abdul Puranwala from B&K Securities India Private Limited. Please go ahead.

Abdul Puranwala: My question is a follow-up question to the previous participant asked. As you said that the new facility would be operational within 100 days. Do we have that sort of visibility that it would start generating revenues later from Q2 FY19 onwards or how it will pan towards?

Sucheth Rao: So Abdul just to understand your question, you said that we have mentioned that the facility will become operational in 100 days and what is it that you asked after that?

Abdul Puranwala: Would it start generating sales as well or you will start expensing that in the P&L?

Sucheth Rao: We are looking at Unit 3 in two ways, Abdul. We are looking at how Unit 3 can contribute to our bottom-line by doing products which are either we are currently outsourcing or procuring from China. For those kind of products, it will not add any additional sale. It will actually impact our margins positively once the fixed expenses are covered in Unit 3. Apart from that, we are also looking at other products which will contribute to the overall sales of the organization. For Unit 3, we are looking at two kinds of options. One is to bring in intermediates that we are either currently getting contract manufactured outside or we are procuring from China or other parts of the world. These would not add to the topline of the organization, but they would contribute to the margins assuming that we would be able to cover up fixed cost. Apart from this, we are looking at looking at a second category of opportunities which will actually add to the overall sales coming out of Unit 3 which are other APIs that we can sell more if we have more capacity as well as new products, both intermediates and API that could be scaled up here and immediately sold. So the second category will add to overall sales.

Abdul Puranwala: And sir, now when we have these volume issues we have sorted and that is the capacity issue sorted at our end, we had some pending orders on the GDS segment, so have we started executing them or is that already been done in the past quarter sir?

Sucheth Rao: No. So now we have started, Abdul, so that situation is starting to ease out in Q4 and we expect that by Q1-Q2 FY19 it will be completely eased out where we don't expect to have any backlog of orders.

Abdul Puranwala: Okay, sure. And sir just lastly can you tell us what would be the amount that was being raised for this acquisition and the interest rate at which it was being raised?

Sucheth Rao: No, Abdul. We have kept that information confidential for other reasons. So we have not revealed that information.

Moderator: Thank you. The next question is from the line of Shreeram Rathi from ICICI Securities. Please go ahead.

Shreeram Rathi: Just two questions sir. One is that you mentioned that the things have started improving in terms of volume supplies and everything. So just wanted to understand that in FY17, we were doing a revenue run rate of around 140-150 crores which has now dropped to 110 -120 crores odd. Will this improvement help us in moving back to the earlier levels of revenue run rate of 140 -150 crores or how should we look at that?

Sucheth Rao: I think that is exactly what we expect as well. The reasons that caused the dip in revenues were attributed to less than anticipated volumes of products such as Ciprofloxacin, Salmeterol and there was also an imbalance of our capacity between one manufacturing location and other. So over the past several months what we have done is we have actually invested a lot of time and efforts in terms of balancing capacities and now we have also added Unit 3 as an additional capacity for the overall operations. Given that now we have taken care of the capacity issues and things are falling in place and the fact that we are seeing products such as Ciprofloxacin and couple of CMS molecules bounce back, we do expect that we will catch up with our expected performance.

Shreeram Rathi: Great. That is helpful. Secondly on CMS particularly, I think it was mentioned that there were some lower than expected sales from some commercialized products. Is there any specific issue with the product itself or it is just temporary phenomenon for the quarter that the sales have gone down, have supplies have gone down for us?

Saharsh Rao: There is nothing specific with product, Shreeram. I think it is also a reflection of the fact that the CMS business is still in an evolving stage and there is a lot of lumpiness in that business and it just happened that we didn't have significant orders to our expectation in the quarter, but there is nothing in terms of any change in terms of the product itself.

Shreeram Rathi: Okay, great. Last year, we did I think 134 crores kind of revenues and this year in 9 months we have done around 65 crores. So just wanted to understand that, in the last year whatever revenue we generated from the products, are those products still there in the portfolio, right? I mean nothing has been dropped off?

Saharsh Rao: The revenue if you are talking about FY17, Shreeram, again as I was talking to Ranvir Singh earlier, the revenues for CMS comes from the small projects where we are doing lot of development work as well as the commercial molecules where we have actually, they have already become commercial and we are the commercial suppliers. So the small projects which are still in development, there is always some attrition, some molecules fail in the clinic or there

is no more requirement from the customer etc. and therefore some changes happened in that part of the business which is a development part of the CMS business, but as far as the commercial molecules of CMS are concerned, there has been no change, there has been no droppage of any molecule, all the molecules continue to be there and in fact all of them have contributed in different volumes in FY18, it is just that the volumes have been low.

Shreeram Rathi:

Okay. Got it. Out of 42 total projects, how many are commercial right now?

Saharsh Rao:

Out of the 42 in the pipeline, we have about 5 which are commercial which are APIs.

Moderator:

Thank you. The next question is from the line of Ranvir Singh from Systematix. Please go ahead.

Ranvir Singh:

Sir, would you like to give any guidance for FY19 either in terms of revenue or profitability?

Saharsh Rao:

The short answer is that we won't be giving guidance for FY19. I think comments that Sucheth and I had made with regards where we are with regards to Q4, I think it is the only indication that we are comfortable to share right now and the sense that we feel that our business is getting back to where it used to be. We are in situation where our Cipro business has gotten back to normalcy levels. We are seeing normalcy levels coming in from other CMS molecules as well. But beyond that, we are not comfortable to spell out in terms of guidance.

Ranvir Singh:

Not guidance but in case if some revenue ambition for the next 2-3 years or by 2020, something like that, if you have something in your mind?

Saharsh Rao:

Ranvir, we like your resilience on calls asking for guidance which is good, but all we can mention is that as we said earlier, we expect to grow the business at a rate of 15% to 20%. We believe that our EBITDA margins will reach 20% or north of it. Having said that, obviously any dip in sales directly impacts our EBITDA margin as such. It is not because the product mix has changed, but obviously we start making profits once the fixed costs are covered right and any incremental sales directly contributes to the absolute EBITDA as well as the EBITDA percentage. So having said that whatever you have stated in past in terms of the growth rates and our margins, we continue to stand by that.

Ranvir Singh:

No, my perspective was, looking at the current asset turn even post acquisition and I look at the capacity, I wanted to know whether the more CAPEX would be required over next 2-3 years. So, for 15%-20% growth whether can we expect some bigger CAPEX going forward by FY19 or FY20?

Saharsh Rao:

With regards to the acquisition itself, I think the acquisition is necessary for us to be able to sustain the growth that Sucheth was just indicating, which we have indicated in the past as well. Given where we are in the current financial year which is when significantly weaker compared to our expectation, we look at the outlook that we have shared with regard to 15%-20% growth

and our EBITDA margin of closer to 20%, over a long-term basis. I think the way we would ask you to look at this is the way the Company that has performed over the years. If you look at the last 3-4 years, we have had certain ups and in this year we have also had some challenges and we look at our future also as a journey based on that last four years journey. So it is not a journey that is just based on what we are seeing in FY18 and therefore the growth rate that we are talking about or the EBITDA margins we are talking about are kind of based on that slightly longer term horizon and as far as Unit 3 is concerned, I think Unit 3 acquisition was a big milestone for us in terms of the CAPEX that we have incurred for it. I think going forward we will have to put in more CAPEX to bring it more operational to add more production blocks, to make it more connected to the business. But that CAPEX maybe as part of our annual CAPEX program.

Sucheth Rao:

So just to close the loop on that Ranvir is, typically we spend about 5%-10% of the gross block as a replacement CAPEX every year, right? So that will continue because that is just required to maintain these facilities. As far as Unit 3 is concerned, our primary objective is to to its operational level for which I have mentioned the number earlier and based on the product's expected returns, we will continue to invest further CAPEX to include the capacities, but that will come on the back of products. So we are not envisaging any huge CAPEX before we actually make Unit 3 completely operational.

Moderator:

Thank you. The next question is from the line of Cyndrella Carvalho from Dolat Capital. Please go ahead.

Cyndrella Carvalho:

Sir, just wanted to understand we said that we are seeing some improvement in our business. So I wanted you to help me with some color in the sense that if we look at our prime and niche segments, in terms of our key assets like Cipro, Salmeterol, what is that is giving us a comfort that you know situation is improving. What are the key parameters that we are observing? Would you be able to help us with even in terms of your key assets if you could compare on a nine month basis that what happened here and now what do we see?

Saharsh Rao:

Thanks for the question Cyndrella. What we are seeing is that for Cipro, both the current quarter and whatever forecast that we have received from our customers for subsequent quarters is more in line with our expectations. Based on that what we have made comment that what we have seen the product volume slowly coming back up. In terms of Salmeterol, one of the reasons that we mentioned that lot of the anticipated approvals for Salmeterol had got in delayed because of the complex regulatory approval landscape for this particular molecule. Based on some indications from customers, we have every reason to believe that this will come back up. It hasn't had any significant impact in the current quarter, but we do expect that this will pick up in the subsequent quarters. It is a very similar story for couple of other contract manufacturing molecules where the forecast indicate that the volumes are getting restored. Essentially, we have seen the volumes coming back up in the prime segment for molecules such as Cipro for the specialty of the niche segment for molecules such as Salmeterol as well as the CMS segment.

Sucheth Rao: And I think what also helps us strengthen our view of the business Cyndrella is that many of the challenges we were facing, whether it was capacity constraint because of the load imbalance between the two manufacturing units or maybe even to some extent, pressure on margins for certain products in the prime category, we have been able to get a handle on those challenges as well as I have indicated in the earlier remarks now we have been able to almost complete the load balancing between our two manufacturing units which would mean that there would be no other spillovers hopefully going forward for our products. We will also be able to realize better margins despite there being an environment of pricing pressure. And I think besides the optimism, we are considering from the markets for the product, operationally and from our ability to deliver and from our ability to be more efficient, we are seeing a lot of benefits already in the system. I think it is a collective view of all these factors which is giving us that optimism, but given the kind of business we operate in, we always tend to stay on the cautious side and we will continue to keep sensitizing you guys as we come across new pieces of information.

Cyndrella Carvalho: Sir, you were supposed to re-register a few products from Unit I, Unit II you were supposed to do some transfers, so you had been able to do that? Completed? Is that what you are trying to indicate?

Sucheth Rao: Yes, we have. We have actually successfully transferred about 3 products from Unit I to Unit II, in fact for a couple of them, actually for one of them we have received the revised CEP; however, as you know products still require a written confirmation from the Indian government, so we are waiting on that for one product and for the other product, we are waiting on some additional stability data. So once that goes through, Unit II for these products will come online. On top of that, we are also validating Unit III for some of our products where we expect growth in theyear after that. We are doing this a little bit proactively so that we don't get into kind of a situation that we did in the past where we received a lot of orders to Unit I. Unit II was underutilized and that has impacted in our performance as well. Obviously learning from that we are creating as much flexibility in our operations so that we can deliver or handle all the growth in our sales, but as Harsh said, we continue to be cautious, we will keep updating you. The market changes very quickly in the industry as you know. I think the key is for us to remain sensitive, connected and take corrective actions as quickly as we can.

Cyndrella Carvalho: Just wanted to pick your mind on this again that you are trying to tell me that earlier for our key products say for example if the volume growth had almost gone to say negative levels, do you see that coming to a higher single digit in the coming year or coming quarter onwards or do you see it higher doubles, any sense that you can provide us on that?

Saharsh Rao: I think it is hard to answer the questions you asked Cyndrella. For us, each product has a different characteristic and as we have said we are seeing, with regards to all our products, I think within the prime products, Cipro plays a very important role and I think for Cipro, as we have indicated we are seeing a stabilization of the orders and the outlook from the customers. With regards to the other products, it really boils down to a case by case basis, but as Sucheth had mentioned

earlier, based on the outlook that our customers have given us and as an exercise when we are preparing for an upcoming budget, we reach out to all our customers to try to get a sense of what their requirements for the coming year are. As a whole, it gives us a very positive indication, but beyond that I would not like to, it is really hard for me to delve into specific growth for specific products in their volume movements etc.

Moderator: Thank you. The next question is from the line of Rishabh Krishnan Iyer from Uma K Iyer & Co. Please go ahead.

Rishabh Krishnan Iyer: I have a quick question for you gentlemen. The question is regarding the capacity utilization in this particular financial year, so how do you look at the capacity utilization in the immediate coming quarter as well as in financial year 2018-2019?

Sucheth Rao: Thanks Rishabh. With the capacity utilization also, it depends on the production block or the product mix in that specific block, Rishabh. Currently we do have certain production blocks which are almost running at an 80%-85% kind of a capacity utilization. We have some production blocks which are not lower than that. So based on our product mix changes that will continue to change as well. But overall from an efficiency point of view, would like that we operate at 80%-85% capacity utilization and if we see that number is going to be breached, we immediately want to ensure that we either do a CAPEX or we do some kind of a line balancing that we did in the current financial year to balance the capacity and continue delivering what the market wants.

Moderator: Thank you. The next question is from the line of Rohit Balkrishnan who is an Individual Investor. Please go ahead.

Rohit Balkrishnan: So, one question I had was that in your previous concall you mentioned that the revenues that you could achieve from your two facilities is around 750 crores. I heard you saying that the incremental unit that you have got would not add to the topline. So I mean, is my understanding correct that what I heard because I joined a bit late so I just wanted to understand.

Saharsh Rao: I think your understanding is correct Rohit. What we have indicated in the opening part of the call was that the new facility, we don't expect it to contribute to the topline in this quarter or the upcoming financial year where we expect the new facility to have an impact is to help us backward integrate for some of the important intermediates that we currently source from China as well as other suppliers and thereby help us improve our contribution and thereby help us improve our margins. I think that is where we see the new facility playing a role in terms of the upcoming quarters, but with regards to the capacity of unit I, unit II together, we had earlier indicated that based on an optimum product mix, the two facilities together could do up to 750 crores and when we talk about an optimum product mix, I mean just to give you a sense it would mean the volumes of Ciprofloxacin, volumes of Salmeterol and various other products that we have and that mix giving us about 750 crores or so. The important underlying point over there

is that in the absence of say hypothetically speaking Salmeterol and substituting that with Ciprofloxacin, then perhaps you would never be able to generate 750 crores from that revenue. Then we will only be able to do 650 crores or maybe even lesser from that revenue. So I think in that sense, the 750 crores number that was indicated was based on an optimum product mix, but going forward what we had also mentioned earlier is that the successful integration of unit III would mean that new APIs would get scaled up over there, new CMS projects would get scaled up over there and eventually that unit III probably from next financial year which is not FY19, but by FY20 would start contributing to topline in terms of being able to deliver new products from that facility.

Rohit Balkrishnan: Understood. That is helpful. The second question I had was that as you mentioned that in CMS business, there has been some slowdown in this year. So I just want to understand at a broader level, so first is that if you can, first one numbers question was, out of that 65 crores how much would be contributed by let us say commercial based projects, would you share that?

Sucheth Rao: We don't have the specific numbers Rohit, but I think I would say majority would be coming from the commercial products, but we don't have the exact split and we have not really gotten into providing that.

Rohit Balkrishnan: That is helpful. But the reason why I was asking was that, so the understanding that I had was that CMS is more sticky kind of business and once you supply a kind of volume, it doesn't down from there. So just wanted to know what is the reason for the decline in volumes and at the broader level just wanted to understand, is the understanding correct that being a sticky business volume seldom sort of go down?

Sucheth Rao: Generally speaking your understanding is correct Rohit. CMS tends to be a sticky business because you tend to be in a mutually exclusive relationship with the customer and the customer still having the product patent etc. has a fair runway on the product itself. So conceptually, the CMS business is sticky, but what also is important reality of our business is that some of the CMS molecules that are part of our portfolio today are molecules which are just getting commercial and any new molecule which is getting commercial whether it is generic or especially a new chemical entity, there is always a period of uncertainty where customers end up stock piling and then there is a period where they are waiting for the sales to pick up and then they again place orders in lumps. So in a steady state basis if we had a portfolio of CMS projects where they all have been commercial for a fair period of time, then the business would be absolutely stable and predictable, but since our portfolio is still quite young, we have a couple of molecules which have been commercial for several years now and those give certain level of stability, but some of the candidates are all molecules which have become commercial very recently and they tend to have lot of volatility in them. So I think in a nutshell, as our business continues to mature on the CMS side, as these 42 projects that we are talking about have more candidates get into commercial and as this portfolio increases, we think that the volatility of



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February 02, 2018*

these numbers will reduce. But the point we make earlier in our interactions about the CMS business being sticky is absolutely true.

Moderator: Thank you sir. Ladies and gentlemen, due to paucity of time, that was the last question. I would now like to hand the conference over to the management for their closing comments.

Sucheth Rao: Thank you everyone for joining this call and putting forward your questions. We hope that we have been able to answer all the questions and provide further clarity and transparency about Neuland's business. Please feel free to reach out to us directly if you have further questions about business. I think your questions about the unit III ramp up, the volatility of the business, the share of the specialty molecules as well as the overall number of commercial molecules in the CMS business as well as the CAPEX programs and expectations of the future, all of those were helpful and also help us think about our business from different angles. So please continue to have those coming and having said that, I thank you again for your questions and look forward to the next interaction. Thank you.

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