Vivimed

Vivimed Labs Limited

Q2 FY2014 Earnings Conference Call

Management:

Mr. Santosh Varalwar, Managing Director and CEO

Mr. Krishna Yeachuri, Director, VLL Spain

Mr. Saurabh SG, Associate Director, Corporate Strategy

Mr. Phaninder Nath, General Manager, Corporate Accounts

Mr. Raghu Iyer, Vice President, Corporate Strategy

Moderator: Ladies and gentlemen, good afternoon, and welcome to the Vivimed Labs Limited Q2 FY2014 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 at the end of today's presentation. Should you need assistance during this conference call please signal for an operator by pressing "*" followed by "0" on your touchtone telephone. Please note that this conference is being recorded.

Joining us on the call today are Mr. Santosh Varalwar (MD & CEO), Mr. Krishna Yeachuri, (Director, VLL Spain), Mr. Saurabh S.G. (Associate Director, Corporate Strategy), Mr. Phaninder Nath (GM, Corporate Accounts) and Mr. Raghu Iyer (Vice President, Corporate Strategy).

Before we begin, I would like to mention that some of the statements made in today's call may be forward-looking in nature, and may involve risks and uncertainties. For a list of such considerations, please refer to the earnings presentation. I now like to hand the conference over to Mr. Varalwar. Thank you and over to you, Sir!

Santosh Varalwar: Good afternoon everyone for joining us on this call for today. Hope you all had a chance to review our results and performance. This quarter has been very eventful for us with the recent acquisition of the Chennai based, Alathur Solid Oral Dosage facility from Actavis, which is now called Vivimed Alathur.

Integration and consolidation of businesses across all verticals remains one of our highest priorities. We believe that this acquisition is a successful step towards completing the Healthcare Value Chain. At present, we are focused on successful execution of manufacturing contracts that this facility already has with Actavis. We are working towards monetization of the two acquired ANDAs through marketing alliances, distributor arrangements and customer line-ups.

In the near term, we want to drive formulation R&D engine for filing our own formulations from Vivimed Alathur. To become more competitive, we have initiated capacity expansion from the existing 1.2 billion solid oral dosage to 2 billion through debottlenecking and minimal capital expenditure. Going forward, Vivimed Alathur will be our center of R&D excellence responsible for centralized procurement, group quality assurance and regulatory affairs, and also a gateway to the generics markets in USA and Europe.

In Q2 FY2014, we recorded net sales of Rs. 307.3 Crores, representing a year-on-year growth of 11.4%. This is primarily driven by the growth in the Healthcare segment. This was led by continued ramp up of a key CMO account in the API business and consolidation of Vivimed Alathur in the Contract FDF segment. Specialty Chemical segment growth rate declined due to the strategic portfolio rationalization initiative. During the quarter, the Company reduced volumes of less profitable imaging chemical products.

In Q2 FY 2014, Healthcare segment accounted for 68% of net sales; Personal Care segment accounted for 19%; Home Care 11%; and Industrial for only 2% of net sales.

Vivimed reported Q2 FY2014 EBITDA of Rs. 524 million at 17% margins. On a sequential quarter basis, EBITDA margin improved by 285 basis points, driven by improved profitability in the Specialty Chemical business. This is despite the profitability in the Healthcare segment being impacted by prolonged wait for regulatory approvals in the FDF business and some product specific issues in the API business.

Net profit for the quarter was Rs. 164 million at 5.3% margin. During the quarter, our finance cost increased due to higher working capital utilization and an increase in long term loans at the standalone level.

Vivimed continues to make investments in strengthening our R&D base in India, across Healthcare and Specialty Chemical segments. In the Healthcare business, we are positioning ourselves to capitalize our capabilities as an integrated player with a differentiated focus on R&D. In the Specialty Chemical business, Vivimed is focused on successful execution of the recent order wins, even as we invest in new products.

Despite near term challenges, we are confident that with our investments towards a differentiated product pipeline, continued focus on client mining and consistent regulatory track record will hold us in a good stead to deliver long term growth and sustainable profit.

I would now like to hand over the call to Saurabh for giving you an operational overview across our business segments Thank you.

Saurabh S.G.: Thank you Mr. Santosh. Good afternoon everybody I will start with talking about the overview of the Healthcare segment, which is nearly 70% of our revenues. On an overall basis, this segment continued to perform well and reported a near 20% year-on-year growth in the second quarter. However, in the API business, there were certain product specific issues, which resulted in a lower off-take for some key products; and some deferred sales have happened which has now spilled over to Q3 FY 2014.

As far as the API business is concerned, we are targeting process improvements, product repairs, new product development and efficient procurement as key focus areas- which we are looking at for enhancing the profitability of the API business going forward. These initiatives, we believe, will start to deliver results in the year FY2015 on a full year basis. We are confident that the profitability of the API business will be significantly better than what we have reported over the last six months.

The Contract Formulation Business within the Healthcare vertical has experienced a pushback due to a prolonged wait for regulatory approval especially from Russia & CIS markets. Audit was completed in September 2013, finally, and we believe that we will be able to drive higher capacity utilization from this part of the business in the second half of the year.

In the FDF segment, the recent acquisition of the US FDA approved plant in Chennai has now opened the gateway for the regulated market for us. We now have two ANDAs and in-house API manufacturing will drive the domestic FDF to the next level we believe over the next couple of years. During the quarter, the period of consolidation for Vivimed Alathur was about two months and this contributed around 22 Crores to the topline.

In the Specialty Chemical segment, management has taken some strategic decisions to optimize the product portfolio to focus more on higher margin products. As a result of this rationalization initiative, the revenue growth of the segment has declined. In fact, a closer look at the numbers will say that at least for the last four quarters, we have been cautiously letting go of the lower margin segments like imaging chemicals etc., and focusing more on getting the profitability up in the Specialty Chemical Business. This has borne fruit and the operating margin for this segment in the quarter was 21%, which is a significant improvement compared to 15%, which we did in the last quarter.

Within this Specialty Chemical business, in the Skincare segment, we increased our market share and higher allocation to the existing clients. We also saw some new opportunities open up in markets like Latin America. Within the segment, new product introduction and sampling remain core focus areas for the second half of this financial year. In the Hair Care segment, we reported encouraging volume growth in the Middle East. There is now increased client penetration and opportunities for one customer at least in the LatAm market. In the Specialty Chemical business, Vivimed is in the process of adding two new in-marketing initiatives to the distribution vertical, in addition to what we are already running. We believe this will all lead to an outcome of a stronger go-to market strategy for the business going ahead. In new products, we have identified certain new peptide products, which we are looking to invest in and hopefully we will be able to monetize them over the next two to three years and they should see a scaled increase in revenues and profitability in the Specialty Chemical business. For the Specialty Chemical business, key priorities remain execution of the new order wins which we have got and invest more towards the new product pipeline, which is an ongoing activity.

Overall on a firm wise basis, Vivimed is focusing on delivering long-term value to shareholders, despite the near term challenges which we are seeing. The key drivers, which we believe we will utilize to deliver this, are optimal utilization of the manufacturing platform, integrating our acquisitions and leveraging global scale into the model which we have right now. We are actively looking at rationalization of portfolios across both businesses and also keeping an eye on our cost structures to keep the focus on margin enhancement consistent over the next couple of quarters. We will actively look to engage with clients, on a deeper basis, and look to introduce new products in both segments. Investment in R&D is a priority, which is going up significantly and this quarter we have spent nearly 5% of our sales on R&D compared to a typical run-rate of 3.5% to 4%, we have seen 12 months ago. As Mr. Santosh mentioned, we are very clearly looking at differentiated R&D in both the segments and we believe that this is the only way we will secure a stronger competitive positioning in the years to come.

With this I will now open the floor for questions and answers and we will be happy to take all your questions. Thank you.

Moderator: Thank you very much Sir. Participants, we will begin the question and answer session. We have the first question from the line of Mr. Ashok Shah from Labdhi Finance. Please go ahead.

Ashok Shah: Good afternoon to everybody. My questions are - first of all, there is an increase in preference capital as on March 31 and as on September 30. Please explain, what are the interest rates? When is the conversion going to take place? Secondly, how is the Company going to reduce debt and increase the profitability margins, as the interest rates are increasing quarter by quarter?

Saurabh S.G: I think, Mr. Ashok Shah just to answer your first question, the equity share capital has increased from 161 million to 162 million in this quarter. This is mainly because of allotment of shares to complete the Finoso acquisition that was in January. So for a key management team member of Finoso, we have allotted shares which are nearly equivalent to 1% of the outstanding share capital. So there is 1% dilution, which has happened because of allotment of shares to complete the acquisition. That is point number one. The second question - as far as debt is concerned, I think debt, as the numbers will show, has gone up quarter-on-quarter. This is because of two reasons; one is we have taken some additional debt to complete the Actavis acquisition, as we mentioned in the last conference call. There has also been an increase in the debt notionally, because of mark-to-market to current exchange rates given that a significant part of our long-term borrowings is in foreign currency. So there has been some increase due to that.

Ashok Shah: My question was regarding the increase in preference capital of Rs. 64 Crores? What is it?

Saurabh S.G: There is no increase in the preference capital. It is the same as it was last time.

Ashok Shah: What are the terms? Is it convertible or is it just interest bearing?

Santosh Varalwar: The preference share has only been given in the Mauritius entity. That is conversion into 2016 as per agreement.

Ashok Shah: Conversion to IFC, or to whom?

Santosh Varalwar: At that time, we would look at either conversion into the capital at the Vivimed Labs Spain level, or then we might, based on the valuation, give them a swap in the listed company in India. So, in 2016, we will deal with this situation.

Ashok Shah: That is available in consolidated capital only?

Santosh Varalwar: Yes, right.

Ashok Shah: One more question - can you give some details of the various lands available to the Company, may be in Hyderabad, Andhra Pradesh or Vizag. Is there a plan to monetize it, to reduce the interest burden?

Santosh Varalwar: As we mentioned, most of the land acquisitions happened about two to three years back or four years back when we had not really gone into the inorganic route, i.e. acquisition of Uquifa. The intention of the land acquisition at that point was clearly that we wanted to expand into API segment, also build a US FDA approved formulation facility. So we have gone ahead and acquired a large chunk of land in Visakhapatnam as well as in Hyderabad. So, eventually in 2011 you are aware that we have done the acquisition of Uquifa. We have acquired three US FDA approved facilities, which are not anymore target or any more a priority to invest now on that segment. Similarly, the Hyderabad land which we acquired was also primarily meant for building up a greenfield US FDA approved facility, but as luck would have, the acquisition of the Chennai-Alathur facility also has taken away the need for going ahead and investing on the greenfield. So, you are right. I think the value of these two lands if you really take it should be in the range of 100 Crores and as a company, we do not feel the need to retain such a large chunk on a long-term basis. Strategically, we will still retain a part of it. But I think the large chunk, we are not. So, in the recent Board meeting, I think there has been a consensus in monetizing that and eventually in the next 12 months' time, definitely, we will look into monetizing the whole vacant land or unutilized land available in the Company.

Ashok Shah: Are you going to monetize in Hyderabad or in Vizag?

Santosh Varalwar: I think we need to at both the places, because in Vizag, it is a large chunk. It is more than 270 to 280 acres land and out of that, I think, one third is what we intend to keep and balance we will explore to monetize. Hyderabad I think we do not need it because we already have the plants, so we are also trying to monetize that.

Ashok Shah: What is the size of Hyderabad land?

Santosh Varalwar: Hyderabad land is about 30 acres roughly and in Vizag that is about 270 acres.

Ashok Shah: What is the investment made in Hyderabad and Vizag?

Santosh Varalwar: In Vizag, we have investment of about 70 Crores, roughly and in Hyderabad we made about 6 Crores.

Ashok Shah: What is the present approximate value?

Santosh Varalwar: Present value in our opinion should be like twice of what we had invested. Now, depending on the demand and situation, i.e., the political situation prevalent, will add appropriately, and would like, to monetize it at a reasonable price.

Ashok Shah: Regarding this Alathur, what sales can be realized after expansion, total at full capacity utilization?

Santosh Varalwar: Alathur, right now as we mentioned, we have a capacity of 1.2 billion SOD part of it is tablet and capsule - but then I think as I just mentioned about it, we are planning to do a minimal capital expenditure to put a balance in equipment and to raise the capacity to 2 billion. So, our actions - as far as this is concerned - we have an active contract with Actavis which will run up to July 2014. I think that will keep us busy. At least a capacity utilization of 30% to 40% should take care. But more than that - I think we have an active ANDA, which we have recently signed a distribution agreement with one large distributor in the US. So that should also give us some capacity utilization. But then, we also initiated some CB30s which will also kick off and will probably come in the first quarter of next year. So, my guess is that, in this year we will still be doing about 40% to 45% capacity utilization, but next year with increased capacity, we should target at least 60% and above.

Ashok Shah: But sales wise, what will be the sales in next year at 60% capacity?

Santosh Varalwar: At 60% capacity, we are targeting about 150 Crores next year.

Ashok Shah: Margin wise, EBITDA wise, it will be giving you 20% margin?

Santosh Varalwar: I think the product selection is very important here because initially our intent would be to keep for the capacities going on, i.e., we will file CB30 where I do not think we will expect any higher margin. When we start as we have already started filing ANDAs. Our target is to file about six ANDAs this year from that facility and when the ANDAs get approved, that is the time we should look at margins above 20%. But before that I guess, it is difficult to think about two digit margins in Alathur.

Ashok Shah: Any fresh development in Spain and Mexico, margin wise?

Santosh Varalwar: In Mexico, we are reshuffling in terms of products and obviously that should result in margin improvement next year. We do not see any great deal happening this year. But next financial year that is going to go up. As far as Spain is concerned, our focus obviously is partly on the CMO business, which is performing pretty well and we have very firm indications that those volumes are going up next year which will result in better margins.

Ashok Shah: Can you give some rough idea on how next three years - what sales company would be going to?

Santosh Varalwar: If you have observed it, I think Vivimed is growing at 20% to 25% per year. As Saurabh just mentioned, our R&D spend is going up. This is clearly with the intent that we want to increase our product filings in regulated markets, where the drug master files or ANDA is there, or adding more products in Specialty Chemical segment, and are expanding in the domestic branded segment. I think as we are spending a lot of money on that. We also see a lot of pipeline coming up. In the near term - in the very short-term - I would not say that we are going to see the fruition of all these efforts, but I think 12 months to 18 months from now, I think these new filings are going to come into the revenue stream and that should really show up in terms of numbers. Well my guess is that with the existing situation that is there - what we at least see - a 20% to 25% growth year-on-year seems to be a pretty reasonable target.

Ashok Shah: Thank you for giving me the opportunity.

Moderator: Thank you. As there are no further questions from the participants, I would now like to hand the floor back to the management for closing comments. Over to you, Sir!

Santosh Varalwar: Thank you ladies and gentlemen, for being with us on this Q2 Earnings Call. I guess we have given a very detailed view of our business as it goes forward. As we already mentioned, the greatest development in the last two quarters has been integration of the Healthcare value chain. May be two quarters back, we had been more of an API company, but in the last two quarters, the significant development of acquiring the US FDA facility and also the FDF R&D facility makes Vivimed an integrated pharma player without losing its focus on the growth of Specialty Chemical. As we mentioned, the Specialty Chemical is still dear to us and we are growing this business - and lot of efforts are on in terms of expanding this business transglobal. We have expanded a significant presence in Latin America, and we are also doing a lot of efforts in new product range. As I said, I think Vivimed today poses a great platform in terms of the pharmaceutical segment with a completely integrated healthcare value chain and also with initiatives that we have done in Specialty Chemical and also penetration into branded FDF markets in India. So my guess is that with all these three platforms right there, the efforts are on to see that we move from this level to the next orbit. I think my team is very upbeat about opportunities rising in front of it. And I am sure the next few quarters will be pretty exciting for all of us. Thank you for being with us. We will continue to update you on any new developments. Thank you very much.

Moderator: Thank you Sir. Ladies and gentlemen, on behalf of Vivimed Labs Limited, that concludes this conference call. Thank you for joining us. You may now disconnect your lines.

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Note: This document has been edited to improve readability