Vivimed

# Vivimed Labs Limited

## Q3 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 Q3 FY2014 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 the conference, please signal 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 and 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 maybe forward looking in nature and may involve risk and uncertainties. For a list of such considerations, please refer to the earnings presentation.

I now 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 today. Hope you have had a chance to go through the earnings presentation which is also available on the Company website. I will start the call by providing an overview of the last quarter performance and some of the initiatives that we are taking. Then I will pass on the call to my colleague, Saurabh, to provide you a detailed operational overview on the whole business.

The last quarter saw revenue growth coming from both our business segments - Healthcare and Specialty Chemicals. We remain focused on integration and consolidation across business lines, which we believe will deliver improved and sustainable profitability, as we move forward.

In Q3 FY2014, we recorded consolidated net sales of Rs. 3,358 million, which is a 22.4% growth over the same period last year. Sales growth in the Healthcare business was 29.0% year-on-year, largely driven by momentum in the API business, in particular in the CMO business. This business has seen ramp up in a key custom manufacturing engagement and increased market share in key generic products. Specialty Chemicals business grew 12.4% year-on-year as key customer accounts have seen encouraging scale up. EBITDA margins improved by 242 basis points on year-on-year basis to 16.0%, due to improved profitability across both the Specialty Chemicals and Healthcare segments. Specialty Chemicals segment profitability has increased as a result of product portfolio rationalization, cost optimization, and efficient operations. Healthcare Segment profitability improved as a result of higher capacity utilization, product repairs and cost optimization initiatives.

The net profit increased by 12.2% to Rs. 190 million during the quarter. However, this could have been better as we continue to have issues in terms of approval at one of our FDF plants in Hyderabad, which is still awaiting approval from the CIS authority. There has been an increase in R&D cost at Uquifa because we have stepped up on our R&D expenses and R&D work particularly in Hyderabad. We have also formed additional teams which are responsible to file new DMFs. We expect to file at least 4-6 DMFs in the current calendar year and that is what the cost increase is owing to. We also see an increase in certain employee costs at Uquifa mainly because of the ramp up of CMO business which we will see more of in the coming year.

In the Healthcare segment, Vivimed is working on a slate of new product filings in both its API and finished formulations businesses targeting the regulatory markets. We hope to leverage our strong API manufacturing platform to enhance market access and competitiveness over the medium term. In the Specialty Chemicals segment, Vivimed is focused on three aspects – new products, new customers and new geographies. Building a differential product pipeline and new distributor appointments in regions to capture market share have been some of the key initiatives undertaken in the last quarter. We have also seen in the last quarter, some of the projects which we expected to see growth coming in Q1 & Q2 - they all yielded in Q3 - but I think the main traction will come from Q4 onwards. So, this is a period of transition for both our businesses and we are confident that these will be the building blocks of a growing, profitable and capital efficient enterprise over the medium term. With this I would now hand over the call to Saurabh.

**Saurabh S.G.:** Thank you Mr. Santosh. Good afternoon to everybody who has joined us on the call today. I will start by providing you a brief operational overview of the Healthcare segment, which is nearly 68% of our sales for the quarter. Within the Healthcare segment, we look at the business within two sub verticals; one is API, which is about 55% of our consolidated sales and the Formulations business which is nearly 15% of the consolidated sales.

In the API business, as Mr. Santosh mentioned, our investments in R&D have begun to ramp up now and as a result of which we have been able to deliver some repairs to our current product portfolio slate which has increased our profitability. Also, efforts are underway, so that we are able to more efficiently backward integrate manufacturing of intermediates which will help our API business profitability going ahead also. So, basically the factor of these two initiatives has led to, the year-on-year Healthcare vertical margin moving up from less that 5% to closer to 7% at EBIT level over the last 12 months. So, these two initiatives, we will continue to gain traction over the next 12 months.

As far as new products go, we are looking at filing new products for the European and the US geography in the API business and we expect that these will start contributing to the revenues over the 18-24 months. We are looking at filings, which are differentiated and not mass volume filings. We are looking at a higher set of filings which we would be in a position to talk about, I think more comfortably, in the next quarter or so.

In the API business, as Mr. Santosh mentioned, apart from the generic API business which is an ongoing exercise, the CMO, the Custom Manufacturing Engagement, is something which has seen good traction for us and we have been able to grow on the back of ramp up of a key customer account. This is an area which we believe we will further leverage on our manufacturing presence in Europe as this is a high value exercise for us and the profitability in the CMO engagement is better than what we experience in the generic API business. We have also made certain talented additions in the CMO business for the group and we hope that this will lead to a significant jumpstart as far as CMO vertical focus is concerned in the next 18 to 24 months.

Now coming to the second aspect in the Healthcare business, which is the Formulations business, which is nearly 15% of our overall consolidated sales. Looking at formulations from an ROW angle one of our facilities in Hyderabad is still awaiting regulatory approval which has led to lower capacity utilization and this is something which we believe will correct itself in the next quarter as we have just about finished the regulatory process in that facility. The other business which is there in the Formulation business is of course our Alathur facility which we acquired from Actavis sometime in middle of the last year. The news from Alathur has been pretty encouraging; we are looking at three aspects. One is the continued execution of the engagement which we have with Actavis to cater to their certain products which is pretty much ongoing. Secondly, we are also looking at ramp up of our own filings from Alathur. The strategy which we will be following is that we will be looking to file those finished formulations where we already have a captive API which is reasonably strong in terms of market access. So I believe this will enhance competiveness of the final formulation as and when we approach the market. And also, within Alathur, we acquired two ANDAs with the facility and we are looking at better traction from these two molecules as we have already got into the engagement with certain distributors and since then certain CB30s have been filed. So this should lead to the capacity utilization in the Alathur business picking up over the next 12 months. And the CIS market for which we are awaiting approval, if that comes through, the formulation business could see pretty decent numbers in the next 12 months or so.

I will now briefly touch upon our Specialty Chemicals business which is nearly 30% of consolidated sales for the last quarter. As we have been saying this is the business where we have differentiated presence and we are experiencing good traction in terms of customer accounts which are large consumer product companies and we have been the beneficiary of the overall trend for these consumer product companies moving to LATAM and emerging markets. So pretty much global personal care segment is on its own track and we will be looking at certain new product additions in some interesting ranges like Peptides which we believe will offer significant potential in terms of revenues and profitability over the next 18 months.

As far as business focus is concerned, we have made certain distributor appointments especially in the LATAM region and the Middle East which would see us get better market shares for the differentiated product portfolio which we have. We are pretty confident of the Specialty Chemicals business delivering more than market growth rate and continuing to remain a profitable part of the group for us. As you are aware, the Specialty Chemicals business where we make consistently 20% EBIT margin, we are confident that this trend will continue and we should see revenue growth also picking up as key customer accounts start ramping up in the next quarter or so.

So that is all from my side as far as the business is concerned and as just to reemphasize what Mr. Santosh has mentioned - that the integration and consolidation efforts are underway and we are firmly focused on improving our return ratios to get at par with what typical industry players have been performing and the way we will approach it, is through improving our capacity utilization which we are already seeing some initial signs of both in the Specialty Chemicals and the Healthcare businesses. We hope that margins will gradually start picking up from where we are today. This is the first quarter in this financial year, where we have shown year-on-year growth in EBITDA and net profits. And this has been on account of a better margin profile and we believe that gradually we will start reverting to our historical level margins in the next 18-24 months. And third aspect is tighter working capital, which we believe we see enough scope for, specifically, in the domestic business to leverage upon. So these three factors are something which we as a management team are driving at and hopefully this will result in better capital efficiency ratios for the group going forward, in the next 18-24 months. And these remain key priority areas for the management team.

So with these I would now like to open up the floor for interactive Q&A. We will be happy to take questions.

**Moderator:** Thank you. Ladies and Gentlemen, we will now begin with the question and answer session. We have the first question from the line of Yash Vaid from India Infoline. Please go ahead.

**Yash Vaid:** What was the CAPEX for the quarter? And what is your revenue mix in terms of segments, if you can tell us?

**Saurabh S.G.:** Let me take that first, so just to break up, I think we have done Rs. 335 crores, if I am not wrong, for the quarter. And out of which nearly Rs. 228 crores is Healthcare - nothing but pharmaceuticals - and the balance is Specialty Chemicals. Within Rs. 228 crores, API business is Rs. 176 crores and the Formulations business is around Rs. 52 crores - and that is the balance. And what is the profitability - overall if you would see, there is Specialty Chemicals business we have been doing more than 20% plus at EBITDA level. That has been the trend this quarter too. And for the Pharma business, this is an area where we are focusing our energies on and trying to get the margins up, especially in the API business. And I think this is the segment where we are doing around 12-13% sort of a margin right now.

**Yash Vaid:** And also, I want the numbers in terms of domestic and international?

**Santosh Varalwar:** Yes I can tell the answer. I will give you little more break-ups than what Saurabh has provided. Out of the Rs. 335 crores revenue, API was about Rs. 176 crores this quarter and Specialty Chemicals was about Rs. 107 crores and contract FDF, which is mainly a domestic business was about Rs. 45 crores. And branded FDF was about Rs. 6.6 crores. Out of this, API business is completely exports. Specialty Chemicals, about 60% of Rs. 107 is exports. Contract FDF and branded FDF are completely in the domestic market. So you can say, more than 60% of the revenues are export revenues. And the second question that you asked regarding CAPEX, this quarter, we had about Rs. 3 crores CAPEX - and that is mainly out of Uquifa Spain. There is no CAPEX incurred in India.

**Moderator:** Next question is from the line of Ashok Shah from Lucky Finance. Please go ahead.

**Ashok Shah:** Good afternoon to everybody. My question relates to the last conference call question – first is the matter regarding the liquidation of the extra assets which the Company has - what is a realizable value from these assets? Second, company has got 9 plants in India and 3 plants outside India, so can you just inform, that what is the capacity utilization of these plants and how this capacity utilization is going to be increased over next 1 year? And third question is, how company is going to reduce the interest via increasing margins or when the company will be increasing the margin over next 1 year to normal level in Pharma business?

**Saurabh:** Mr. Ashok let me just answer your last 2 questions, the first question I think Mr. Santosh can fill us in on. Looking at the question which you asked about the capacity utilization - you are right, we have 3 plants which are overseas are 9 plants here in India, I think if you look at system wide capacity utilization, we are probably running around 60-65% and we believe that there is enough which we can produce from these facilities, so obviously increase in capacity utilization both in the overseas factories as well as the domestic factories is a key criterion and this is one of the areas we are focusing on so that our return ratios get better without spending too much of money on capacity increase. The third question which you asked about margins - I think what we are doing in the Healthcare business, as I mentioned - and I will give some more detail - where we are seeing areas for improvement in margins, of course API business where if you see, we are looking at maybe 11-13% sort of EBITDA margin, versus Formulations which is 17-18%. So, our goal basically is to reach a margin - to see improvement in this API EBITDA margin by at least 150-200 bps in the next 12-15 months. How we are going to do it, is essentially through backward integration i.e. once we start ramping up our manufacturing of intermediates in India to be supplied to our API business overseas and we also start delivering more effectively on R&D and start introducing new products, and, getting the repairs on the current products which we have, so that we will become more competitive and our profitability will go up. So, that is how we are approaching the increasing margins attempt which is on in the Pharma business - through better capacity utilization and more delivery of intermediates and R&D efficiency from India for the API business to move to a better margin profile than what it is right now.

**Santosh Varalwar:** Adding to what Saurabh said, in the short term, of course there will be some of the key products which we had margin pressures in - we did go back to customers and asked for enhancement in pricing which we sorted during this month, which should help us in the short term in improvement in margin. And also as I mentioned, the new filings which once we do, we are expecting better margins over there. Then capacity utilization as Saurabh said, once we ramp up, more tonnage coming out of these plants with the same cost base there, I think EBITDA margin should look better from all prospects. And FDF business, once we have the Hyderabad plant up and going, which I guess now it has been more than 9 months that we had a serious setback in terms of audit compliance and awaiting for clearance from a regulatory authority. I think once that gets off the ground that should really show up in terms of margins.

You are talking about the land which we discussed last time - Vizag land monetizing - I did mention last time that we did appoint Knight Frank, a leading property consultant to look at the opportunity of monetizing it. We are working on it but as you are aware with the political scenario, with - Seemandhra, Telangana - all these hassles going on, there is a little bit of uncertainty in terms of everything and we probably will have to wait till the middle of this financial year before we could really see something happening. Until these political things settle down, I guess the companies and other people who are looking at the prospect of this land should probably wait for some more time.

So, I guess eventually yes, that is right Mr. Ashok. We will look to monetize this which will help us reduce our debt which has also increased on account of acquisition of Alathur in the last half year. And on the Alathur facility - which is USFDA - we have spent some money in terms of ramping up capacity and we will also be spending money going forward filing ANDAs, so it really is a very important thing for us in terms of monetizing the land.

**Ashok Shah:** Regarding this taxation, tax paid is only Rs. 2 crore, so is it going to be like that or taxation matter has a very low level?

**Saurabh:** Mr. Shah, in one of the overseas subsidiaries, we have had a deferred tax asset which has led to the consolidated tax rate being lower - I think 10% or so. But on a full year basis, by the time we close March we will be closer to 15-20% band as far as the tax rate is concerned. And this will go up next year.

**Ashok Shah:** So, from 15% it will go up to 18 or 20% on a consolidated level?

**Saurabh:** We can assume at least 2-3% there will be increase next year in the tax, I guess.

**Ashok Shah:** So, even today what is the forward scenario you are looking for your March ending and next year sales wise?

**Santosh Varalwar:** As I see the last quarter was a good quarter and we have seen a good development in January so we hope to maintain the same revenues or maybe a little better than this, in terms of the last quarter. So, in terms of margins, yes as I mentioned, Specialty Chemicals business started picking up good business. We are seeing a ramping up of certain customers and FDF business other than the Jeedimetla plant, most of the other plants are looking good. API business, as Saurabh gave you an insight on, we have a very strong order book at least for the next 4 months and overall order book seems to be pretty satisfactory, so we expect the closing of this quarter to be definitely better.

**Ashok Shah:** So, it will be similar to the last year of 2013 on a net profit basis, almost?

**Santosh Varalwar:** It should be good. I cannot comment on how much profitability, but in terms of order book position, it looks pretty robust and pretty good. Going forward we will share more information as we go up to the end of this quarter.

**Ashok Shah:** What is our plan for increasing the sales in the branded business?

**Santosh Varalwar:** We have seen, since we brought this brand in the FDF segment in 2011, I think we have grown the business and we have also launched new products in ophthalmic segment. We have not seen the improvement in sales as far as the new launch is concerned, but I guess with the expanded geographies, there has been mixed reactions - Tamil Nadu is really performing very well, whereas Andhra Pradesh - there has been little setback owing to the political situation. Particularly in the Seemandhra area, people are unable to work but I am sure that the new products are really good and we should see them going up in the last quarter and beginning of the next year first quarter. And with the improved geographies and new product additions, we expect a reasonably good jump in terms of revenues and profitability from the branded FDF business going forward.

**Ashok Shah:** What is your short-term and long-term debt?

**Santosh Varalwar:** Long term borrowings are in the range of about Rs. 372 crores and short term borrowings are about Rs. 328 crores. So, that is in the range of about Rs. 700 crores.

**Moderator:** As we have no further questions, I would like to hand the floor back to the management for closing comments, please go ahead.

**Santosh Varalwar:** Thank you everybody for being with us on this Q3 Earnings Call. As we explained, the Healthcare business as well as the Specialty Chemicals business is gaining traction and more so in Healthcare, activity is pretty high, whether it is in terms of API business in Spain and Mexico or the CMO business and back in India with FDF business. So, with the acquisition of the Alathur, the USFDA approved facility, there are lot of activities that have started in the last 6 months, in terms of new ANDA filings, in terms of acquiring new customers for contract manufacturing. And also, we have seen one of our ANDAs mainly Losartan, going into the US market for the first time, so I am sure from the long term growth perspective, these initiative that we have taken particularly in the last 6 months will definitely prove beneficial to the Company and with larger traction R&D and with more people in that R&D level and targeting filing ANDAs and DMFs, I am sure the pharmaceutical business will see a quantum jump in the years to come. Our Specialty Chemicals has been steady till date, we are expanding - geography, customers and products. So I am sure now with the new team there, an expanded team, we are going to see great progress and expect to have better numbers in the near future. But still the work is in progress and I would really like to see all our efforts come to fruition in 18 to 24 months which is where we will see all the efforts that have gone in the last one year coming in to real effect.

So thank you very much for being with us and we will come back again. Thank you.

**Moderator:** Thank you sir. Ladies and gentlemen that concludes this conference call. Thank you for joining us and you may now disconnect your lines. Thank you

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*Note: This document has been edited to improve readability*